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# SECTION 500

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## Reporting Phase

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**Figure 500.1: Methodology Overview**

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## Reporting Phase

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### 510 - OVERVIEW

- .01 Based on the work in the preceding phases, the auditor must form conclusions on the information in the financial statements, the entity's internal control, the financial management systems' substantial compliance with the three FFMIA requirements, the entity's compliance with laws and regulations, and other information (management's discussion and analysis (or the overview of the reporting entity), required supplementary information (unaudited RSSI is considered required supplementary information), and other accompanying information). Additionally, findings coming to the auditor's attention should be reported in an appropriate manner. The following sections provide guidance to assist the auditor in making these determinations and in formulating the report type and form. Guidance is also provided on other activities that should be performed by the auditor during the reporting phase. (See figure 500.1.)

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## **Reporting Phase**

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### **520 - PERFORM OVERALL ANALYTICAL PROCEDURES**

#### **PURPOSES OF OVERALL ANALYTICAL PROCEDURES**

- .01 As the audit nears completion, the auditor must perform overall analytical procedures as required by GAAS (AU 329). These procedures, which are part of the reporting phase, have the following purposes:
- to determine if an adequate understanding of all fluctuations and relationships in the financial statements has been obtained from other audit procedures,
  - to determine if other audit evidence is consistent with explanations for fluctuations documented during overall analytical procedures, and
  - to assist the auditor in forming an opinion on the financial statements that is consistent with the conclusions reached during tests of individual account balances and classes of transactions.
- .02 If overall analytical procedures indicate that an adequate understanding of relationships and fluctuations has not been obtained or if there are inconsistencies in audit evidence gathered from other audit procedures, further inquiries and testing are necessary to obtain an adequate understanding or to resolve the inconsistencies.
- .03 The auditor may find it effective and efficient to perform overall analytical procedures in more detail than the financial statement level (supplemental analytical procedures) and then use the results of these procedures to "roll up" into and support the overall analytical procedures at the financial statement level. For example, the auditor might perform overall analytical procedures at the account level and roll them up to the financial statement line item to which they belong.
- .04 The auditor may choose to use analytical procedures to obtain complete or partial substantive assurance for certain accounts or to perform supplemental analytical procedures when detail tests are used exclusively to obtain substantive assurance. The information obtained during these procedures can be used as the basis for explanations of fluctuations for overall analytical procedures.

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**Reporting Phase**  
**520 - Perform Overall Analytical Procedures**

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- .05 Having the auditor who conducted the detail tests on an account also conduct supplemental analytical procedures usually maximizes efficiency and effectiveness by building on the knowledge of the account obtained during detail tests.
- .06 Overall analytical procedures should be coordinated with the auditor's evaluation of the MD&A (overview of the entity) included in the Accountability Report (annual financial statement). For example, the auditor should use the MD&A, if available, to assist in performing overall analytical procedures and should use the results of the analytical procedures to assist in forming conclusions about the information in the MD&A.

**PERFORMANCE OF OVERALL ANALYTICAL PROCEDURES**

- .07 The auditor should take the following steps to achieve the purposes of overall analytical procedures described above:
- **Compare current-year amounts with comparative financial information and with budget execution information:** This information may be on a summarized level, such as the level of financial statements, or a more detailed level, as discussed in paragraph 520.03. If available, audited prior-year information that is comparable to the current-period information should be used for comparison. If audited prior-year information is not available, the auditor should use any other information that provides a reasonable basis for comparison. The audited, final amounts for the current year must be used for these procedures. The auditor may also perform ratio analysis on current-year data and compare these with ratios derived from prior periods or budgets.
  - **Identify significant fluctuations:** The auditor should establish parameters for determining if a fluctuation is significant. Fluctuations identified are a matter of the auditor's judgment. The auditor should also consider the absence of expected fluctuations when identifying significant fluctuations.
  - **Understand identified fluctuations:** The auditor should understand all significant fluctuations identified. The causes for the fluctuations should be briefly described and referenced to corroborating evidence in the workpapers. If the auditor does not understand the cause of the

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**Reporting Phase**  
**520 - Perform Overall Analytical Procedures**

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fluctuation or if the understanding is not consistent with the evidence in the workpapers, the auditor should perform appropriate procedures to obtain an understanding or to resolve any inconsistencies.

- **Consider the results of overall analytical procedures:** The auditor should consider these results to determine if an adequate understanding of significant fluctuations was obtained and evidence is consistent and adequate to support the report on the financial statements.

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## **Reporting Phase**

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### **530 - DETERMINE ADEQUACY OF AUDIT PROCEDURES AND AUDIT SCOPE**

- .01 In the planning phase, the auditor determined planning materiality based on preliminary information. Based on planning materiality, the auditor determined design and test materialities, which affected the extent of testing. In light of the final assessment of combined risk, the overall level of audit assurance used, and the audited materiality base, the auditor should consider whether the extent of substantive audit procedures was sufficient (i.e. appropriateness of sample sizes for detail tests and the limit for investigation of differences during substantive analytical procedures). When there are questions regarding the adequacy of work performed, the auditor should consult with the Reviewer to determine the necessity of additional procedures.
- .02 When determining whether an opinion can be expressed on the financial statements, any limitations on the nature, timing, or extent of work performed should be considered. Additional guidance on scope limitations and their impact is provided in paragraphs 580.14-.18.

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## Reporting Phase

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### 540 - EVALUATE MISSTATEMENTS

#### OVERVIEW

- .01 The auditor may detect misstatements during substantive tests or other procedures. These misstatements should be evaluated in both quantitative and qualitative terms. Based on this evaluation, the auditor should determine the type of report to issue on the financial statements.
- .02 Additionally, the auditor needs to consider the implications of misstatements on the following.

- The auditor's evaluation of internal control (see paragraphs 580.32-.61)

*Consider whether the misstatements indicate control weaknesses that had not been previously identified, whether the assessment of the controls remains appropriate, and whether the categorization of control weaknesses for reporting purposes is appropriate.*

- The consideration of the risk of material misstatement due to fraud (see paragraphs 540.18-.21)

*Consider whether the accumulated results of audit procedures and other observations would change the risk of material misstatement due to fraud identified during planning.*

- The auditor's evaluation of the financial management systems' substantial compliance with the three FFMIA requirements (see paragraph 580.62-.66)

*Consider whether the misstatements would have a significant impact on the auditor's conclusions with respect to the financial management systems' substantial compliance with the three FFMIA requirements.*

- The entity's compliance with laws and regulations (see paragraphs 580.67-.75)

*Consider whether the misstatements would change the auditor's conclusions with respect to the entity's compliance with laws and regulations.*

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**Reporting Phase**  
**540 - Evaluate Misstatements**

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- budget formulation and execution

*Consider whether the misstatements would have a significant impact on budget related matters for purposes of reporting budget control weaknesses, reporting on the statements of budgetary resources and financing, and reporting on compliance with budget-related provisions of laws and regulations.*

- Other reports

*Consider whether the misstatements and any underlying internal control weaknesses affect reported performance measures or other reports prepared by the entity that are (1) used for management decision-making or (2) distributed outside the entity.*

.03 The auditor should follow the guidance in sections 475 (substantive analytical procedures) and 480 (substantive detail tests) regarding evaluation of individual misstatements from a quantitative standpoint. Following that guidance, the auditor should quantify the effects of the misstatements and classify them as follows:

- **known misstatement:** the amount of misstatement actually found or
- **likely misstatement:** the auditor's best estimate of the amount of the misstatement (including the known misstatement). For sampling applications, this amount is the projected misstatement. (Also see paragraph 540.11.)

**ACCUMULATION OF MISSTATEMENTS**

.04 To evaluate the aggregate effects of misstatements on the financial statements, the auditor should accumulate the adjustments necessary to correct all known and likely misstatements on the Summary of Possible Adjustments. This schedule should include all misstatements detected by the auditor, including any that the entity corrected during the audit. It is important to consider all misstatements to have a record of the impact of the audit, bring all misstatements to the attention of the appropriate level of management, and assist the auditor in evaluating the risk of further misstatement as a part of the consideration of unadjusted misstatements

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**Reporting Phase**  
**540 - Evaluate Misstatements**

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(paragraphs 540.11-.12). An example format is included as section 595 C. The Reviewer should review the Summary of Possible Adjustments. Per AU 312.40, the auditor may designate an amount below which misstatements need not be accumulated. This amount should be set so that any such misstatements, either individually or when aggregated with other such misstatements, would not be material to the financial statements, after the possibility of further undetected misstatements is considered.

- .05 The financial statements usually include various estimates made by management, such as the recoverability of assets (allowances for doubtful accounts receivable or loans) and liabilities for loan guarantees. If the recorded amount falls outside of a range of amounts that the auditor considers reasonable, the auditor should consider the difference between the recorded amount and the closest end of the auditor's range to be a likely misstatement to be included in the Summary of Possible Adjustments and should discuss the difference with entity management.
- .06 Additionally, the auditor should consider whether management's estimates consistently overstate or understate components of the financial statements, such as total assets or total expenditures. If so, the auditor should consider the effects on the financial statements in addition to any unadjusted misstatements when determining the appropriate type of opinion. Further guidance on evaluating estimates is provided in AU 312.36 and AU 342.

**REVIEW OF MISSTATEMENTS WITH MANAGEMENT**

- .07 After accumulating and summarizing the adjustments, the auditor
- **must** bring all misstatements found (except those below the auditor-designated amount at which misstatements need not be accumulated) to the attention of appropriate entity management;
  - **should** encourage entity management to adjust the entity's records to correct all known misstatements; and
  - **should** encourage entity management to determine the cause of the likely misstatements and to make appropriate adjustments; unless the entity's analysis determines another adjustment is appropriate, the auditor should encourage entity management to establish valuation allowances for likely misstatements, net of known misstatements (since

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**Reporting Phase**  
**540 - Evaluate Misstatements**

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the likely misstatement represents the best estimate of the correction needed).

- .08 In presenting the proposed adjustments to management, the auditor should remind management that SAS 89 requires the audited entity to indicate in the management representation letter that the unadjusted misstatements, individually or in the aggregate, are not material to the financial statements taken as a whole. SAS 89 also requires that a summary of the unadjusted misstatements be attached to the representation letter. Thus, management may consider some of the same factors presented in paragraphs 540.09-.16.

**CONSIDERATION OF UNADJUSTED MISSTATEMENTS**

- .09 If entity management declines to record adjustments for any misstatements, the auditor considers the potential effects of these misstatements on the auditor's report in both quantitative and qualitative terms. The auditor should prepare a Summary of Unadjusted Misstatements, following the format provided in section 595 D or equivalent. Overall guidance on evaluating misstatements is provided in AU 312.34-.40. If total unadjusted likely misstatements are material, the auditor should modify the opinion on the financial statements (see paragraph 580.22). Misstatements, individually or in the aggregate, are material if, in light of surrounding circumstances, it is probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the correction of the items. The concept of materiality includes both quantitative and qualitative considerations. Deciding whether and how to modify the opinion based on the materiality of total unadjusted likely misstatements is a significant auditor's judgment. The decision and the basis for it should be documented. The Audit Director should be involved in the decision and review the documentation related to it. Also, the Reviewer should review and approve the documentation of the decision.

**Quantitative Considerations**

- .10 Although there is some point where unadjusted likely misstatements would generally be considered material, there is no single amount that can be used for deciding to modify the opinion. Instead, the auditor should follow a process that considers a number of quantitative factors in reaching this decision.

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**Reporting Phase**  
**540 - Evaluate Misstatements**

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- .11 The auditor should add an allowance for further misstatement to the unadjusted likely misstatement. This risk of further misstatement relates to the imprecision of audit procedures. This risk includes the allowance for sampling risk (the combined precision of all sampling applications), an allowance for imprecision of analytical and other substantive audit procedures, and an allowance for unaudited immaterial account balances. The Statistician should compute the combined precision for all sampling applications.
- .12 This total of likely misstatement plus allowance for further misstatement should then be considered in relation to planning materiality and the relative importance of the misstated items to readers of the financial statements to determine whether the financial statements as a whole may be materially misstated. For example, if the aggregate unadjusted likely misstatement is \$10 million and the allowance for imprecision of audit procedures is probably no more than \$15 million, the auditor should determine whether the total (\$25 million) materially misstates the financial statements taken as a whole. The Reviewer should be consulted in considering these issues.
- .13 The auditor's report addresses the fair presentation of the financial statements as a whole. When considering the effects of any unadjusted misstatements on the financial statements, the auditor should bear in mind that he/she is taking less responsibility for individual line items in the financial statements and in any combining statements and supplemental schedules than for the financial statements as a whole.

**Qualitative Considerations**

- .14 The auditor should consider numerous qualitative factors when determining the effect of unadjusted misstatements on the auditor's report. The auditor may choose to modify or qualify the report on the financial statements, even if the amounts of any unadjusted misstatements are not quantitatively material. Examples of misstatements for which the auditor may consider issuing a modified or qualified report include
- misstatements of account balances or transactions that are considered sensitive to the financial statement users;

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**Reporting Phase**  
**540 - Evaluate Misstatements**

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- misstatements that offset one another in the aggregate but are individually significant; and
- misstatements that have a significant effect on the MD&A (overview) presented by management, including the entity's performance indicators.

**Treatment of Unadjusted Misstatements Detected in Prior Periods**

- .15 The auditor should consider the effects on the current-period financial statements of any misstatements detected in prior periods. If corrected in the current period, the auditor should record the impact on current-period financial statements in the Summary of Possible Adjustments. If uncorrected, the auditor should consider the misstatement in combination with current-period misstatements. Guidance is provided in AU 312.37.

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

- .16 If, during the audit of the current period, the auditor detects a misstatement that arose in a prior period but was not previously detected, the auditor should determine if the misstatement is material to the prior- or current-period financial statements. If the misstatement is considered to be material, the auditor should consult the Reviewer to determine the effects on the current-period statements and the auditor's report. Any material misstatements of this type should be discussed with entity management and should be included on the Summary of Possible Adjustments if not corrected through a prior-period adjustment to the financial statements.

**MANAGEMENT DISAGREEMENT WITH LIKELY MISSTATEMENTS**

- .17 If management disagrees with the auditor's likely misstatements and if the disagreement involves amounts that are material, the auditor may consider the following options:
- The entity may perform procedures, such as reviewing all or substantially all of the items in the relevant population, to refine the estimated amount of the misstatement. In these situations, the auditor should test management's procedures and conclusions.



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**Reporting Phase**  
**540 - Evaluate Misstatements**

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- The auditor may believe that sufficient evidence has already been obtained and may form his/her opinion on the financial statements based on his/her estimate.
- The auditor may want to increase assurance in the likely misstatements in order to convince entity management of the amount or to support the report on the financial statements. For example, the auditor may choose to increase his/her assurance in the likely misstatement by testing additional items. These additional procedures will most likely increase the auditor's assurance in the previous findings but generally will not materially affect the amount of the likely misstatement. Before deciding to perform additional procedures, the auditor should obtain agreement from entity management on the extent of additional evidence needed to be persuasive to them. The auditor also should consult with the Reviewer before beginning any of these additional procedures.
- The Audit Director may decide not to expend additional resources to resolve the disagreement, for example, because additional testing is unlikely to provide different conclusions. If the auditor believes the estimate is sufficiently accurate, he or she would express a qualified or adverse opinion, depending on the materiality of the item to the financial statements taken as a whole. If the auditor believes the estimate is not sufficiently accurate, he or she would qualify or disclaim an opinion for a scope limitation, depending on the materiality of the item to the financial statements taken as a whole.

**RECONSIDERATION OF FRAUD RISK**

- .18 The consideration of the risk of material misstatement due to fraud is a cumulative process that should be ongoing throughout the audit. The auditor should consider whether the audit test results indicate the need for a change in the original consideration of fraud risk made in planning (see section 260) or whether the results indicate a need for additional or different audit procedures.
- .19 When audit tests identify misstatements, the auditor should consider whether these may be indicative of fraud. If the auditor determines that misstatements are or may be the result of fraud, he or she should consult with the Audit Director and the Reviewer who will determine whether to seek help from the Special Investigator Unit and/or OGC. If the effect is not

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**Reporting Phase**  
**540 - Evaluate Misstatements**

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material to the financial statements, the auditor should consider the implications, especially regarding the organizational position of the individual(s) involved. If the person involved in the fraud is a relatively low-level employee, there is little significance to the audit, although the misstatement should be reported at least to the next level of management. However, if the person is of a higher level of management, even though the amount of misstatement found is immaterial, the auditor should consider whether it may indicate a more pervasive problem and should reevaluate fraud risk as well as the assessment of inherent and control risk; the assignment of personnel; and the nature, timing, and extent of substantive testing.

- .20 If the misstatement is or may be the result of fraud and the effect could be material or the auditor is unable to evaluate whether the effect is material, he or she, in consultation with the issue area director, should (1) consider the implications on other aspects of the audit (see previous paragraph), (2) discuss the matter with at least the next level of entity management and with senior management, (3) consider whether to attempt to obtain additional evidence to determine whether material fraud has occurred or is likely to have occurred and the effect on the financial statements and the audit report, and (4) consider whether to advise entity management to consult with its general counsel.
- .21 Fraud involving senior management and fraud that causes a material misstatement of the financial statements should be included in the audit report in the compliance section and in the report on the financial statements section if the financial statements are misstated. When the auditor identifies evidence of these cases, the Special Investigator Unit and/or OGC should be consulted. If the auditor has identified fraud risk factors that have continuing control implications, the auditor should consider whether these risk factors represent reportable conditions that should then be included in the audit report in the internal control section.

**FINANCIAL MANAGEMENT SYSTEMS**

- .22 For audits of the CFO Act agencies and components identified by OMB in its audit guidance, the auditor should determine whether the entity's financial management systems comply substantially with the three requirements of FFMIA. Federal financial management systems requirements and the SGL at the transaction level were considered in sections 350 and 360. At this

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**Reporting Phase**  
**540 - Evaluate Misstatements**

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point, the auditor should reassess those preliminary conclusions and conclude on the federal accounting standards based on the results of control, compliance, and substantive testing and evaluation of misstatements found. If the auditor concludes that the systems do not comply with the requirements, he or she should report the noncompliance. In addition, if the auditor concluded the systems were not in substantial compliance with FFMIA based on limited testing, he or she should report that the work on FFMIA would not necessarily disclose all instances of lack of substantial compliance with FFMIA requirements. (See section 580.)

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## **Reporting Phase**

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### **550 - CONCLUDE OTHER AUDIT PROCEDURES**

.01 To issue the auditor's report, procedures in the following areas should be concluded during the reporting phase:

- inquiries of attorneys (see paragraphs 550.02-.03),
- subsequent events (see paragraphs 550.04-.06),
- management representations (see paragraphs 550.07-.11), and
- related party transactions (see paragraph 550.12).

#### **INQUIRIES OF ATTORNEYS**

.02 In considering any contingent liabilities or uncertainties that may affect the entity or its financial statements, the auditor should make inquiries of the entity's counsel regarding litigation, claims, and assessments. Guidance on these inquiries, as well as on interpreting and using responses received from counsel, is provided in AU 337 and 9337 and OMB audit guidance (see also section 280).

.03 The inquiries and responses should cover the entire period under audit and the subsequent period through completion of fieldwork (the date of the auditor's report). A response should be obtained from counsel at the approximate end of fieldwork. If a long period elapses from end of fieldwork to report issuance, a subsequent update generally should be obtained, either written or oral (and documented in the workpapers), for material events to report issuance.

#### **SUBSEQUENT EVENTS**

.04 Events or transactions may occur after the balance sheet date but before the audit report is issued. Such events or transactions that have a material effect on the financial statements and therefore require adjustment to or disclosure in the financial statements are referred to as subsequent events. AU 560 provides guidance on determining whether a particular subsequent event requires adjustment to or disclosure in the financial statements (see also section 1005).

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**Reporting Phase**  
**550 - Conclude Other Audit Procedures**

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- .05 To identify subsequent events that would require either adjustment to or disclosure in the financial statements, the auditor should follow the procedures described in AU 560.10-12 (see also section 1005). These procedures should be performed at or near the completion of fieldwork. If a long period elapses from end of fieldwork to report issuance, the procedures generally should be updated for material events through the issuance of the auditor's report. The auditor should follow the guidance in AU 530 on dating the auditor's report if any subsequent events are identified that affect the report.
- .06 The auditor generally has no obligation to perform procedures to identify subsequent events after the report is issued. If the auditor becomes aware of facts that might have affected the report if they had been known before issuance, the auditor should follow the guidance in AU 561.

**MANAGEMENT REPRESENTATIONS**

- .07 The auditor is required to obtain written representations from management as part of the audit. These representations supplement the other audit procedures performed by the auditor but are not a substitute for them. Written representations help avoid any misunderstandings that could arise if only oral representations were received from management. In some circumstances, corroborating evidence for representations may not be readily available, such as for those involving management's intent concerning a future transaction or business decision. AU 333.06, AT 501.44 (SSAE 10, paragraph 5.44), and AU 801.07 provide examples of the written representations usually obtained from management (see also sections 1001 and 1001 A). Additionally, the auditor may request representations on other matters.
- .08 Federal government auditors should obtain further representations from management in addition to those required by generally accepted auditing standards. These are management assertions about the effectiveness of internal control and about substantial compliance of financial management systems with the three requirements of FFMIA.
- .09 If management refuses to provide the requested written representations, the auditor considers this a limitation on the audit scope and modifies the report (see paragraphs 580.14-.18). In these situations, the auditor should consider

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**Reporting Phase**  
**550 - Conclude Other Audit Procedures**

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the reliability of other representations received from management during the audit.

- .10 The representation letter should be signed by members of management who, in the auditor's view, are responsible for and knowledgeable, directly or through others, about the matters in the representation letter, as discussed in AU 333.09.
- .11 The representation letter should be dated as of the date of the auditor's report. If there is a significant delay between the report date and the issuance of the report, the auditor should consider obtaining updated management representations.

**RELATED PARTY TRANSACTIONS**

- .12 The auditor should be aware of the possible existence of relationships with related parties and material related party transactions that could affect the financial statements. AU 334 provides guidance on identifying related parties, examining related party transactions, and considerations for disclosure (see also section 1006).

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## Reporting Phase

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### **560 - DETERMINE CONFORMITY WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES**

- .01 Generally accepted accounting principles (GAAP) for federal government entities are developed by the Federal Accounting Standards Advisory Board (FASAB), an entity created by GAO, OMB, and Treasury. FASAB was recognized by the American Institute of Certified Public Accountants (AICPA) as the body to establish GAAP for federal governmental entities under Rule 203, "Accounting Principles," of the AICPA's *Code of Professional Conduct*. Pursuant to the resolution adopted by the AICPA Council on October 19, 1999, Statements of Federal Financial Accounting Standards (SFFAS) issued by FASAB are recognized as GAAP for the applicable federal governmental entities. FASAB develops federal accounting concepts or standards and transmits them to the Comptroller General, the Secretary of the Treasury, and the Director of OMB (the three principals). The accounting concepts or standards become final 90 days after transmittal, provided no principal advises FASAB of an objection during the 90 days. The concepts or standards are then issued by FASAB.
- .02 Federal executive agencies are to follow the hierarchy of accounting principles given below. This means that the entity is to use the guidance in item "a" unless that item is silent about a particular topic. In that case, the entity is to use the guidance in item "b," unless it also does not address the topic, and so on to item "c," or "d," until guidance addressing the topic is found. This hierarchy is recognized by the AICPA as GAAP for applicable federal entities, according to SAS 91:
- a. FASAB Statements and Interpretations plus AICPA and FASB pronouncements if made applicable to federal governmental entities by a FASAB Statement or Interpretation.
  - b. FASAB Technical Bulletins and the following pronouncements if specifically made applicable to federal governmental entities by the AICPA and cleared by FASAB: AICPA Industry Audit and Accounting Guides and AICPA Statements of Position.
  - c. AICPA AcSEC Practice Bulletins if specifically made applicable to federal governmental entities and cleared by FASAB and Technical Releases of its Accounting and Auditing Policy Committee.

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**Reporting Phase****560 - Determine Conformity With Generally Accepted Accounting Principles**

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- d. Implementation guides published by FASAB staff and practices that are widely recognized and prevalent in the federal government.
- .03 In the absence of a pronouncement in the above hierarchy, the auditor may consider other accounting literature, including FASAB Concepts Statements; pronouncements in categories "a" through "d" above when not specifically made applicable to federal governmental entities; FASB and GASB Concepts Statements; GASB Statements, Interpretations, and Technical Bulletins; AICPA Issues Papers; International Accounting Standards of the International Accounting Standards Committee; pronouncements of other professional associations or regulatory agencies; AICPA *Technical Practice Aids*; and accounting textbooks, handbooks, and articles.
- .04 Entities are required to summarize the significant accounting policies used in the notes to the principal statements.
- .05 The auditor should review the financial statements for conformity with GAAP and should identify any instances of nonconformity. Such nonconformity may include incomplete disclosure or use of an accounting principle that is contrary to GAAP. A Checklist for Reports Prepared Under the CFO Act is in section 1004 (Part II) for reviewing the financial statements for appropriate and adequate disclosure in accordance with GAAP.
- .06 The auditor should consider the impact of nonconformity with GAAP on the financial statements and should determine the effects, if any, on the auditor's report (see paragraph 580.22).

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## **Reporting Phase**

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### **570 - DETERMINE COMPLIANCE WITH GAO/PCIE *FINANCIAL AUDIT MANUAL***

- .01 The auditor must determine whether the audit was conducted in accordance with GAGAS, OMB audit guidance, and GAO/PCIE financial audit methodology. The auditor should use the audit completion checklist included in section 1003 (Part II) for determining and documenting compliance.

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## Reporting Phase

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### 580 - DRAFT REPORTS

- .01 At the conclusion of the audit, the auditor finalizes the draft of the auditor's report(s), which includes the auditor's conclusions on
- the financial statements (see paragraphs 580.10-.31);
  - internal control (see paragraphs 580.32-.61);
  - whether the financial management systems substantially comply with the requirements of FFMIA: federal financial management systems requirements, federal accounting standards (GAAP), and the SGL at the transaction level (see paragraphs 580.62-.66); and
  - compliance with laws and regulations (see paragraphs 580.67-.75);
  - the MD&A (see requirements in SFFAS No. 15) and other information included in the Accountability Report (including RSSI) (see paragraphs 580.76-.81).
- .02 The auditor's report should clearly identify the entity audited, the Accountability Report on which the auditor is reporting, and the period covered by the Accountability Report.
- .03 The report should be dated as of the completion of fieldwork. If a subsequent event occurs after that time that requires disclosure in the report, the auditor should follow the guidance in AU 530 with respect to dating the report.

### REPORT FORMAT

- .04 An example of an unqualified auditor's report is presented in section 595 A. The auditor may use another reporting format, such as issuing separate reports on the financial statements (see AU 508) and on internal control and compliance (see *AICPA Audit and Accounting Guide: Audits of State and Local Governmental Units* or OMB audit guidance) and should document the reasons for deviations from the language required by the professional standards. GAO auditors also should document the reasons for deviations from the example reporting format or language in sections 595 A and/or B. The example report includes the following sections:

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**Reporting Phase**  
**580 - Draft Reports**

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- Introduction;
- Significant Matters (when applicable);
- Conclusions on
  - financial statements,
  - internal control,
  - financial management systems' substantial compliance with FFMIA requirements,
  - compliance with laws and regulations, and
  - consistency of other information;
- Objective, Scope, and Methodology; and
- Agency Comments and Our Evaluation (if applicable).

.05 The introduction summarizes the auditor's conclusions on the entity's financial statements, internal control, financial management systems' substantial compliance with the three FFMIA requirements, and compliance with laws and regulations.

.06 A significant matters section is included if any of the following situations exist:<sup>1</sup>

- significant limitations on the scope of the audit (paragraphs 580.14-.18, .34-.36, and .73-.75);
- uncertainties for which the auditor disclaimed an opinion (paragraph 580.19);
- material departures from generally accepted accounting principles (paragraph 580.22);
- material weaknesses in internal control (including performance measures controls) or other weaknesses that the auditor has decided to describe in the audit report (paragraphs 580.51-.55);

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<sup>1</sup> The auditor may include certain other matters in this section as discussed in paragraphs 580.26-.27.

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- material conflicts between the Summary of Management's Report on Internal Controls prepared under FMFIA and the results of the auditor's evaluation of internal control (paragraph 580.61);
- instances of lack of substantial compliance with the three requirements of FMFIA (paragraphs 580.63-.66)
- instances of noncompliance that are reportable under GAGAS or OMB audit guidance, that is, any that are not clearly inconsequential (paragraphs 580.71-.72);
- material inconsistencies between other information (MD&A, required supplementary information, including RSSI, and other accompanying information) and the financial statements, or material nonconformity of the other information with OMB guidance for such information (paragraphs 580.76-.80); or
- any other significant matters coming to the auditor's attention, that in his/her judgment, should be communicated to the entity head, OMB, and the Congress.

This section should be phrased similar to an executive summary. Matters should be described in nontechnical language so that report users can readily grasp their significance. Other sections of the report would not repeat this narrative, but would refer to it using phrases such as "as described above." If two or more of the above items affect the same area, the auditor should combine the discussion of the situations to the extent possible. Each significant matter should begin with a summary heading. Also, if significant matters exist, the auditor's report should indicate that such matters were considered in forming the audit conclusions (as discussed in section 595 B, note 1).

- .07 The conclusions section of the report is used to report the auditor's overall conclusions on the financial statements, internal control, financial management systems' substantial compliance with the three requirements of FMFIA, compliance with laws and regulations, and consistency of other information.
- .08 The objectives, scope, and methodology section includes a discussion of management's and the auditor's responsibilities, what the auditor did to

fulfill his/her responsibilities, the scope of the auditor's work on internal control, and a statement that the audit was performed in accordance with GAGAS and OMB's audit guidance.

- .09 The remainder of this section provides guidance on forming conclusions on the financial statements, internal control, financial management systems' substantial compliance with the three requirements of FFMIA, compliance with laws and regulations, and other information.
- Example report wording of an unqualified auditor's report is included in section 595 A.
  - Section 595 B provides guidance on modifying the report based on the auditor's conclusions. In some cases, when findings are extensive, the report format may also be modified.

#### **FINANCIAL STATEMENTS**

- .10 Under GAAS, the fourth standard of reporting on financial statements follows (see AU 508.04):
- "The report shall either contain an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an overall opinion cannot be expressed, the reasons therefor should be stated. In all cases where an auditor's name is associated with financial statements, the report should contain a clear-cut indication of the character of the auditor's work, and the degree of responsibility the auditor is taking."
- .11 When reporting on financial statements, the auditor considers the following areas: (1) audit scope, (2) uncertainties, (3) consistency, and (4) departures from GAAP. Each of these areas and their effects on the report are discussed below.
- .12 The auditor considers these four areas and the results of all audit procedures performed to determine if an opinion can be expressed on the financial statements and, if so, the type of opinion. If an opinion cannot be expressed, the auditor should issue a disclaimer report. If an opinion can be expressed, the auditor may issue one of the following opinion types: unqualified, unqualified with an explanatory paragraph, qualified, or adverse.



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- .13 The auditor should formulate the type of report on the financial statements following the guidance provided below and in sections 595 A and 595 B.

Audit Scope

- .14 To express an opinion, first the auditor must determine if the audit has been conducted in accordance with GAGAS and OMB audit guidance. If the auditor is not able to perform all procedures considered necessary, the scope of the audit is considered to have been limited or restricted.
- .15 Restrictions on the scope of the auditor's work may be imposed by the entity or may be caused by circumstances beyond the entity's control. Scope limitations may result from the timing of the audit work; the inability to obtain sufficient, competent evidential matter; or inadequate accounting records. If the audit scope has been limited, the auditor should refer to the guidance in AU 508.22-.28 to determine whether to qualify or disclaim an opinion.
- .16 When determining if sufficient competent evidence has been obtained, the auditor should consider the impact of any misstatements on the audit scope from a qualitative standpoint. The auditor should also consider whether the audit scope is adequate in light of any misstatements or other findings that indicate noncompliance with laws and regulations.
- .17 Whether to qualify or disclaim an opinion because of a scope limitation is a matter of the auditor's judgment. The auditor should assess how important the omitted procedures were to his/her ability to form an opinion on the financial statements. This assessment is influenced by the nature, significance, and magnitude of the items to which the omitted procedures relate. For example, the potential effect of a scope limitation on a material account is likely to be greater than on an immaterial account.
- .18 If the audit scope is adequate for expressing an opinion, the auditor determines the appropriate type of opinion. Three areas that the auditor should consider when forming the opinion are uncertainties, consistency, and departures from GAAP.

Uncertainties

- .19 Uncertainties are matters affecting the financial statements whose outcome is expected to be resolved at a future date when conclusive evidential matter will become available. Uncertainties may be related to the resolution of litigation or the valuation of assets, such as real estate owned. Uncertainties include the contingencies discussed in SFFAS No. 5 (amended by SFFAS No. 12), estimates covered by AICPA Statement of Position 94-6, as well as other matters. Guidance on considering uncertainties and their effects on the auditor's report is provided in AU 508.29-.32 (SAS 79). Depending on the nature of the uncertainty, the auditor may need to add an explanatory paragraph or disclaim an opinion, as discussed in AU 508. Because of the nature of uncertainties, conclusive evidence cannot be expected to exist at the time of the audit. Management is responsible for estimating the effect of future events on the financial statements or determining that a reasonable estimate cannot be made and making required disclosures. The auditor generally should give an unqualified opinion if, in his or her judgment, evidence is sufficient to support management's analysis of the nature of the uncertainty and its presentation or disclosure in the financial statements. (The auditor may add a matter of emphasis paragraph; see AU 508.19.) Additionally, if the uncertainty involves a scope limitation (unavailable or insufficient evidence to support recorded amounts or disclosure relating to the uncertainty) a qualification or disclaimer may be appropriate as discussed in paragraphs 580.28-.29 and .31 (see AU 508.29-.32). If the uncertainty involves a departure from accounting principles (inadequate disclosure, inappropriate accounting principles, and unreasonable accounting estimates), the auditor may need to express a qualified or adverse opinion as discussed in paragraphs 580.28-.29 and .30, respectively (see AU 508.45-.49).

Consistency

- .20 The auditor is concerned with comparability between the financial statements for all periods presented or with the prior period if only 1 year is presented. A lack of comparability may be caused by an inconsistency in the accounting principles used; the method of applying these principles; or other factors, such as the classification of accounts for reporting purposes. For first-year audits, the auditor should determine if accounting principles are consistent with the prior period, following the guidance in AU 420.22 -.25. Guidance on the auditor's consideration of accounting and other changes that may affect the consistency of the financial statements may be found in AU

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420. Inconsistencies may result in an explanatory paragraph or departure from GAAP. Guidance on reporting on a lack of consistency is provided in AU 508.16-.18.

- .21 If the entity has a change in accounting principles when it first adopts FASAB standards, the auditor should include a paragraph on consistency in the audit report, regardless of whether or not the financial statements of the previous period are presented. The paragraph should state that the entity adopted SFFAS No. X, as discussed in note XX. The SFFASs generally specify what disclosures are required upon adoption.

Departure from GAAP

- .22 The auditor must consider whether the financial statements are materially affected by a departure from GAAP. If such a departure exists, the auditor should determine the extent of the effects of the departure on the financial statements, considering both quantitative and qualitative factors, as discussed in AU 508.35-.36. The auditor also should consider whether adequate disclosures have been made in the financial statements and related notes (see AU 431 and AU 508.41-.44) and should evaluate whether any changes in accounting principles used by the entity are appropriate (see AU 508.50-.57). Depending on the extent of the departure, the auditor should express either a qualified or adverse opinion. Guidance on reporting these departures is included in AU 508.37-.40 for qualified opinions and AU 508.58-.60 for adverse opinions (see section 595 B for modifications to be made to the auditor's report). In rare cases when compliance with accounting principles would result in misleading financial statements, a departure from GAAP may not result in a qualified or adverse opinion (see AU 508.14 -.15).

Types of reports

- .23 As discussed, the auditor may express various types of opinions or may disclaim an opinion. Guidance on reporting is included in AU 411, 420, 431, 504, 508, and 558. Additionally, section 595 A includes an example of an unqualified report. Section 595 B includes specific changes to be made to the unqualified report under various circumstances. Each type of report is discussed in paragraphs 580.24-.31.

*Unqualified Opinion*

- .24 In an unqualified opinion on the financial statements, the auditor concludes that the financial statements and accompanying notes present fairly, in all material respects, the assets, liabilities, and net position of the entity at the end of the period, and the net costs, changes in net position, budgetary resources, reconciliation of net costs with budgetary obligations, and custodial activity (if applicable) for the period then ended, in conformity with generally accepted accounting principles.
- .25 If, in the auditor's judgment, he/she cannot make this conclusion (for reasons discussed in paragraphs 580.14-.22) the auditor's report on the financial statements should be modified. This report modification may take the form of an explanatory paragraph, or the opinion expressed in the report may be qualified or adverse. Additionally, if the auditor opines only on the balance sheet, the auditor should follow the guidance in AU 508.33-.34.

*Explanatory Paragraphs*

- .26 An auditor may express an unqualified opinion and also include explanatory paragraphs in the report. An explanatory paragraph may be included in either the significant matters section or the opinion on the financial statements section of the auditor's report based on the auditor's judgment about its significance. The following types of situations usually require the addition of an explanatory paragraph or other explanatory language. (See AU 508.11 for further guidance.)
- The auditor's opinion refers to another auditor's report.
  - The predecessor auditor's report is not presented for comparative financial statements.
  - The accounting principles or their method of application materially changes between periods. (See paragraph 580.20 for a discussion of consistency.)
  - Certain circumstances exist relating to reports on comparative financial statements. (See AU 508.68-.69 and .72-.74.)

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- Supplementary information required by FASAB or OMB has been omitted, the presentation of such information departs materially from FASAB or OMB guidelines or is materially inconsistent with information in the financial statements, the auditor is unable to complete prescribed procedures concerning such information, or the auditor is unable to remove substantial doubts about whether the supplementary information conforms to FASAB or OMB guidelines. (See AU 558 for guidance on required supplementary information.)
  - There is substantial doubt about the entity's ability to continue to carry out its mission without substantial additional resources or changes in operations (see AU 341).
- .27 An explanatory paragraph may also be added to emphasize a matter, such as significant transactions with related parties, as discussed in AU 508.19. Also, although not required, an explanatory paragraph may be added when the financial statements are affected by uncertainties concerning future events whose outcome cannot be reasonably estimated as of the report date. (See paragraph 580.19 for a discussion of uncertainties.)

*Qualified Opinion*

- .28 A qualified opinion states that except for the effects of the matter to which the qualification relates, the financial statements present fairly, in all material respects, the assets, liabilities, net position, net costs, changes in net position, budgetary resources, reconciliation of net costs with budgetary obligations, and custodial activities (if applicable) in conformity with GAAP. Guidance on qualified opinions is provided in various paragraphs of AU 508.
- .29 The following situations may require a qualified opinion, as discussed in AU 508.20:
- The audit scope is limited (see paragraphs 580.14-.18.)
  - Based on the audit results, the auditor believes that a departure from GAAP had a material effect on the financial statements but has decided not to express an adverse opinion (see paragraph 580.22).

AU 508.21 provides guidance on qualified opinions. Section 595 B provides guidance on specific report modifications for qualified opinions.

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*Adverse Opinion*

- .30 An adverse opinion states that the financial statements do not fairly present the assets, liabilities, net position, net costs, changes in net position, budgetary resources, reconciliation of net costs with budgetary obligations, or custodial activities (if applicable) in conformity with generally accepted accounting principles. This type of opinion is expressed on the financial statements taken as a whole when there are material departures from GAAP as discussed in paragraph 580.22. Guidance on adverse opinions is provided in AU 508.58-.60. Section 595 B provides specific report modifications for adverse opinions.

*Disclaimer Report*

- .31 In a disclaimer report, the auditor does not express an opinion on the financial statements. A disclaimer report is appropriate when the audit scope is not sufficient to enable the auditor to express such an opinion, as discussed in paragraphs 580.14-.18, or when there are material uncertainties involving a scope limitation, as discussed in paragraph 580.19. AU 508.61-.63 provides guidance on issuing disclaimer reports. The reasons that caused the auditor to disclaim an opinion should be described in the significant matters section of the report following the guidance in AU 508.25-.26. Specific guidance on the wording of disclaimer reports is included in section 595 B.

**INTERNAL CONTROL**

- .32 Federal financial auditors may take one of two different approaches to reporting on internal control: (1) management provides an assertion about the effectiveness of its internal control and the auditor expresses an opinion on internal control (see paragraphs 580.38-.48)<sup>2</sup> or (2) the auditor reports weaknesses found but does not give an opinion (see paragraphs 580.49-.50). (OMB audit guidance requires management to include representations about internal control in the management representation letter in either case.) GAO auditors generally express an opinion on internal control. In either

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<sup>2</sup> If the auditor finds no material weaknesses in internal control, the auditor may express an opinion on management's assertion, rather than opining directly on internal control.

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case, the auditor considers whether internal control is sufficient to meet the following control objectives insofar as those objectives pertain to preventing or detecting misstatements, losses, or noncompliance that would be material in relation to the financial statements:

- Reliability of financial reporting—transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements and RSSI in accordance with GAAP, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition.
- Compliance with applicable laws and regulations—transactions are executed in accordance with laws governing the use of budget authority and other laws and regulations that could have a direct and material effect on the financial statements or RSSI and any other laws, regulations, and governmentwide policies identified by OMB in its audit guidance.

The auditor also should report any reportable conditions detected in performance measures controls but does not need to express an opinion on whether internal control is sufficient to meet the objective that data supporting performance measures are properly recorded, processed, and summarized to permit preparation of performance information in accordance with criteria stated by management.

#### Classifying Control Weaknesses

.33 The following definitions and guidelines should be used for classifying internal control weaknesses:

- **A material weakness** is a reportable condition (see below) in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements, whether caused by errors or fraud, losses, or noncompliance in amounts that would be material in relation to the financial statements, RSSI, or a performance measure or aggregation of related performance measures

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may occur and not be detected within a timely period by employees in the normal course of their assigned duties.<sup>3</sup>

- **Reportable conditions** are matters coming to the auditor's attention that in the auditor's judgment, should be communicated because they represent significant deficiencies in the design or operation of internal control, which could adversely affect the entity's ability to meet the internal control objectives described in the report.
- .34 The auditor should consider whether reportable conditions, in combination, result in material weaknesses. If so, the auditor should consider them to be material weaknesses in concluding as to the effectiveness of internal control and reporting findings, as discussed in paragraphs 580.42-.48 and 580.51-.58. Additional guidance on classification of internal control weaknesses is provided in AU 325.
- .35 OMB has provided guidance, supplementing Circulars A-123 (June 21, 1995) and A-127 (July 23, 1993 and revisions in Transmittal Memorandum No. 2, dated June 10, 1999), on materiality for reporting matters under FMFIA. The term "material weakness" as used by OMB in this guidance (FMFIA material weakness) is different from the above definition. Management and the auditor should evaluate the material weaknesses reported under FMFIA to determine whether they meet the auditor's definitions of material weakness and reportable condition for reporting as part of management's assertion about the effectiveness of internal control (see paragraph 580.33).
- .36 According to OMB criteria, an internal control weakness is an FMFIA material weakness under A-123 if it is significant enough to be reported outside the agency, as determined by the agency head (that is, included in the annual Integrity Act report to the President and the Congress).
- .37 According to OMB criteria (A-127), nonconformance of entity budget or accounting information and financial systems is material for FMFIA reporting under A-123 if it is material, as judged by the agency head, when weighed against other agency deficiencies.

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<sup>3</sup> This definition is used to determine whether a material weakness exists. Abbreviated language is used in an opinion report (see section 595 A).



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Opinion on Internal Control

- .38 The auditor's evaluation of the entity's internal control and the results of other audit procedures form the basis for the auditor's opinion on internal control. The opinion may be unqualified, unqualified with reference to reportable conditions, qualified, or adverse. Additionally, there may be restrictions on the scope of the procedures that result in a qualified opinion or a disclaimer report (see paragraphs 580.39-.49). The auditor should communicate any identified internal control weaknesses (including weaknesses in operations controls), as discussed in paragraphs 580.51-.58, and consider the effects of such weaknesses on other reports prepared by the entity (paragraph 580.60).

*Scope of Procedures*

- .39 To express an unqualified opinion on internal control, the auditor must have an assertion from management about the effectiveness of internal control and must be able to perform all of the procedures considered necessary, as described in sections 300 and 450. If there is a restriction on the scope of the audit (i.e., not all of these procedures can be performed), the auditor may need to qualify or disclaim the opinion on internal control. Scope restrictions may be imposed by the entity or may be due to other circumstances. The decision of whether to qualify or disclaim an opinion is a matter of the auditor's judgment regarding the importance of the omitted procedures to forming an opinion on internal control. However, if a significant scope restriction is imposed by the entity, the auditor should disclaim an opinion.
- .40 When determining the severity of a scope limitation on internal control, the auditor should consider the control objectives listed in the report--financial reporting, including safeguarding assets, and compliance with laws and regulations. If the scope of work on internal control relevant to one of these objectives is limited, the auditor may need to qualify or disclaim the opinion on internal control regarding that objective. Also, the auditor should determine whether that limitation affects his/her ability to opine on the other objective. If a scope limitation is encountered for a control objective, the auditor should exercise judgment in determining if it is appropriate to give an unqualified opinion on internal control over either objective. In the case of a scope limitation, the auditor should review the guidance in AT 501.59-.62 (SSAE 10, paragraphs 5.59-.62) and consult with the Reviewer to determine the appropriate type of opinion. Section 595 B contains example

language for situations in which (1) the auditor is satisfied that the scope limitation affects only one control objective and that it is considered appropriate to give an opinion on internal control over the other objective and (2) the auditor believes a disclaimer report on internal control, as a whole, is appropriate due to a scope limitation.

- .41 If the auditor has determined that an opinion can be expressed on one or both of the control objectives, the type of opinion to be given depends on whether any internal control weaknesses are identified and the significance of such weaknesses. In concluding as to the effectiveness of internal control, weaknesses should be categorized, in order of decreasing significance, as (1) material weaknesses, (2) reportable conditions that are not considered to be material weaknesses (other reportable conditions), and (3) other weaknesses less significant than reportable conditions (other weaknesses). Each of these types of weaknesses and its effects on the auditor's conclusion on internal control is discussed below. If no material weaknesses or other reportable conditions are identified, the auditor concludes that internal control is effective in meeting the control objectives.

*Effects of Control Weaknesses on the Auditor's Conclusion as to the Effectiveness of Internal Control*

- .42 Based on the types of weaknesses noted, the auditor should conclude as to the effectiveness of internal control as of the end of the audit period, as discussed in paragraphs 580.43-.47. Management also concludes as to the effectiveness of internal control in deciding what assertion to make.

Material weaknesses

- .43 If material weaknesses exist at the end of the audit period, the auditor should conclude that the entity's internal control is ineffective or effective "except for" the weakness for the control objective(s) that the weakness affects. The existence of a material weakness precludes a conclusion that internal control is effective for that objective. If a material weakness relates only to one control objective, the auditor should determine whether internal control is effective in achieving the other control objective. The auditor should exercise judgment when concluding that the effects of a material weakness are isolated to one control objective.

- .44 The auditor also should exercise judgment in deciding whether it is appropriate in the circumstances to conclude that "except for" a material weakness, internal control is effective for the objective. Management should exercise judgment in deciding what assertion to make about the effectiveness of internal control. By definition, a material weakness is a very significant condition (see paragraph 580.33) that could allow misstatements, losses, or noncompliance of such a magnitude that the judgment of a reasonable person relying on the information would have been changed or influenced. If, after careful consideration, the auditor determines that although a material weakness, the weakness is not severe enough to judge that internal control for that objective is ineffective, he or she may conclude that internal control for that objective is effective "except for" the material weakness. However, if the auditor determines that the material weakness(es) is(are) significant enough that he or she cannot judge internal control to be effective for that objective, even "except for" the material weakness(es), he or she should conclude that internal control is ineffective for that objective. Factors the auditor should consider in deciding whether an "except for" conclusion is appropriate are
- whether there is a single material weakness related to the objective or several,
  - whether the material weakness relates to ancillary areas that are less significant or to one of the more significant aspects of the entity, and
  - whether the material weakness is limited to one or a few assertions that are not generally considered the most significant ones related to the line item or the assertions are quite significant.
- .45 If a material weakness is presented in a report that also includes an unqualified opinion on the financial statements, a statement should be added to the unqualified opinion to indicate that material misstatements may nevertheless occur in other financial information reported by the entity as a result of the material weakness. Example report modifications for material weaknesses are provided in section 595 B.

Reportable conditions other than material weaknesses

- .46 If reportable conditions other than those considered to be, individually or in combination, material weaknesses exist at the end of the audit period, the

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auditor generally may conclude that the controls are effective in achieving the control objectives. However, the auditor's report should be revised (see section 595 B) to highlight that the work performed identified the need to improve certain internal controls.

Weaknesses that do not meet the criteria for reportable conditions

- .47 Weaknesses that do not meet the criteria for reportable conditions (paragraph 580.33) do not affect the auditor's conclusion as to the effectiveness of internal control. They may be reported in a management letter or orally.

*Type of Opinion*

- .48 As described in paragraphs 580.39-.41, if the auditor is unable to apply all the audit procedures he or she considers necessary in the circumstances, a scope limitation exists and the report on internal control may need to be a qualified opinion or a disclaimer of opinion. If all the procedures considered necessary were performed, the opinion may be one of the following.
- If the auditor and management agree as to the effectiveness of internal control and there are no material weaknesses or other reportable conditions in internal control, the opinion on internal control is unqualified (see section 595 A).
  - If the auditor and management agree as to the effectiveness of internal control and there are no material weaknesses in internal control, but there is(are) other reportable condition(s), the auditor modifies the report on internal control by stating that internal control is effective but could be improved and by referring to the reportable condition(s) (see section 595 B).
  - If the auditor and management agree as to the effectiveness of internal control and there are material weaknesses in internal control, the auditor modifies the opinion on internal control by (1) referring to the material weakness(es) noted in management's assertion (which states that internal control with respect to one or both of the internal control objectives--financial reporting, including safeguarding, or compliance--is either effective "except for" the material weakness (qualified opinion) or

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ineffective (adverse opinion)) and (2) describing the material weakness(es). (See section 595 B.)

- If the auditor and management disagree as to the effectiveness of internal control, either because (1) management does not agree that material weakness(es) exist or (2) management does not appropriately modify its assertion about the effectiveness of internal control in light of the material weakness(es), the auditor's opinion is also adverse. (The existence of a material weakness precludes management from asserting that its internal control is effective for that objective.) Thus, an adverse opinion is appropriate if management states that internal control is effective "except for" the material weakness(es) when, in the auditor's judgment, the material weakness(es) is(are) so severe that internal control is ineffective (see paragraph 580.44 and section 595 B).

The auditor should consult with the Reviewer on the opinion on internal control, especially in instances where he or she concludes that a material weakness is isolated to one control objective or that internal control is effective "except for" a material weakness.

#### Nonopinion Report

- .49 If the purpose of the audit is not to render an opinion on internal control, the auditor should report material weaknesses and other reportable conditions in internal control, or state that no material weaknesses were found. (See sections 595 A and/or B.) If, in the auditor's judgment, material weaknesses were so significant that the auditor concludes internal control was ineffective for one or more objectives, he or she may state that conclusion in the report. (See section 595 B.)
- .50 The AICPA, in SAS No. 87, states that a report on internal control in which no opinion is issued is a by-product report, a report that provides a limited degree of assurance about internal control. When no opinion is issued, the report on internal control is not the primary objective of the engagement. SAS 87 states that the auditor should indicate the intended use of the internal control report because of the potential for misunderstanding related to a by-product report's limited degree of assurance. Because the distribution of government audit reports is not restricted, the reports should explain their limitations. (See section 595 A where, in a footnote explaining changes for a nonopinion internal control section, the example report

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cautions the reader that the internal control testing performed may not be sufficient for other purposes.)

Where to Report Control Weaknesses

- .51 The means of communicating weaknesses in internal control depends on the type of weakness, as discussed in paragraph 580.33. Each type of weakness is discussed in paragraphs 580.52-.55 below.

*Reportable conditions (including material weaknesses)*

- .52 If, in the auditor's judgment, a reportable condition is considered to be a significant matter that should be communicated to the entity head, OMB, and the Congress, it should be described in the auditor's report. Any material weakness identified by the auditor should be reported in this manner. These matters should be included in the significant matters section of the auditor's report and combined with related matters to the extent possible as discussed in paragraph 580.06. If management's assertion about the effectiveness of internal control is printed with the audit report, the auditor's report should refer to the discussion of the material weakness (or other reportable condition) in management's assertion.
- .53 The significant matters section of the auditor's report should be limited to summarized information. As such, control weaknesses included in the significant matters section generally should be limited to providing the reader with an understanding of the nature and extent of the weakness. If more complete information concerning the weakness is provided in other reports issued prior to or at the same time as the auditor's report, a reference to such other reports (such as date and title or report number) generally should be included in the auditor's report.
- .54 Reportable conditions not considered to be significant matters individually, as described in paragraph 580.52, should be listed in the significant matters section or in the internal control section of the report. Related weaknesses should be combined. Such weaknesses may be reported in more detail in a management letter (or other written communication). The opinion or report on internal control generally should refer to such letters or communications. To the extent that any such weaknesses contribute to significant matters, they should be described in conjunction with the related significant matter.

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- .55 The auditor may report weaknesses that do not meet the criteria for reportable conditions in a management letter (including the elements that are reported in the management letter as discussed in paragraph 580.57), orally communicate the weakness to an appropriate level of entity management, or determine that no further consideration is necessary. The auditor should document any oral communication or the basis for the decision not to communicate the weakness.

What to Report About Control Weaknesses

- .56 Control weaknesses identified by the auditor are considered to be findings. The "yellow book" (paragraph 6.49) describes the four elements of a finding:
- criteria (what should be),
  - condition (what is),
  - cause (why the condition occurred), and
  - effect (the nature of the possible past or future impact).
- .57 Fully developing each of the four elements of a finding is not always necessary. The auditor should use judgment in applying the resources to investigate a control weakness, based on the elements that are to be reported. For each reportable condition, the minimum extent to which the elements of a finding should be developed depends on how it is communicated.
- **Reportable conditions reported in the auditor's report:** The auditor should identify at least the criteria, condition, cause, and possible asserted effect (as to nature, not necessarily amount) to permit federal officials to determine the effect and to take prompt and proper corrective action. Each reported finding should include a recommendation.
  - **Reportable conditions reported in a management letter:** The auditor should identify at least the condition and the criteria and generally should identify the possible asserted effect. Also, the auditor should provide suggestions for improvements. The auditor should consider the benefits of identifying the cause, which would generally strengthen the suggested improvement.

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In discussing each reportable condition that meets FMFIA reporting criteria, the auditor should state whether the reportable condition was identified in the entity's FMFIA report or in the FMFIA report of the organization of which the entity is a part.

- .58 For weaknesses that do not meet the criteria for reportable conditions, developing all of the elements of a finding is generally not necessary. The auditor should apply judgment to limit the resources applied to investigate this type of control weakness.

Other Considerations

- .59 To communicate audit findings promptly, the auditor should consider issuing reports and/or management letters during the audit. In such instances, the audit report describes significant matters and the general nature of other reportable conditions (as discussed in paragraphs 580.52-.54) and refers to such reports and/or management letters. The reference generally should be sufficient to allow the reader to request these reports and/or management letters. For example, titles and dates or accession numbers generally should be included.
- .60 The auditor should consider whether internal control weaknesses, particularly material weaknesses, could affect information in other reports generated by the entity for external distribution or internal decision-making. The auditor should make inquiries and consider other knowledge obtained during the audit concerning use of reports affected by the weaknesses. The auditor should determine, based on his/her judgment, whether such reports are significant and likely to contain inaccuracies as a result of such control weaknesses that would likely influence the judgment of the report users. If so, the auditor generally should describe, in the auditor's report, the nature of such reports and the effect of control weaknesses on them. In determining if such reports are significant, the auditor should consider whether user judgments or management decisions based on such reports could affect the entity in amounts that would be material in relation to the financial statements.

Reporting on management's FMFIA reports

- .61 In the internal control section of the auditor's report, the auditor considers whether material weaknesses, other reportable conditions, or financial



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management systems' nonconformances identified during the audit were identified in management's FMFIA report. The auditor should investigate any material weaknesses, other reportable conditions, or systems' nonconformances discovered during the audit that were not included in the entity's FMFIA report or the FMFIA report of the organization of which the entity is a part. If the auditor found reportable conditions or systems' nonconformances that should have been reported under FMFIA (see paragraphs 580.35-.37), he or she should refer to them and should determine whether management's FMFIA process has weaknesses that should be reported. Such weaknesses might result from one of the following problems.

- Management did not initially recognize internal control weaknesses or systems' nonconformances, perhaps due to a lack of training or understanding or to limitations in the scope of the FMFIA process. (For example, certain areas were not reviewed annually or certain types of controls or systems were not reviewed.)
- Management did not recognize that identified weaknesses were FMFIA material weaknesses or systems' nonconformances.
- Management relied on controls that the auditor concluded were ineffective.
- Management failed to report identified weaknesses due to inappropriate report preparation (perhaps due to errors in aggregating the internal control weaknesses or systems' nonconformances of branches or agencies).

**FINANCIAL MANAGEMENT SYSTEMS**

.62 FFMIA requires the auditor to report whether the financial management systems of CFO Act agencies or the components designated by OMB comply substantially with three federal financial management systems requirements. These requirements, also required by OMB Circular A-127, are

- federal financial management systems requirements, including those found in the JFMIP functional requirements documents;

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- applicable federal accounting standards, which are now recognized as GAAP (see section 560); and
- the SGL at the transaction level.

**Reporting on Systems' Substantial Compliance with FFMIA Requirements**

- .63 Specific guidance for FFMIA reporting when the auditor determines that the financial management systems are in substantial compliance with the three FFMIA requirements will be provided in the future. OMB and GAO are reviewing this reporting issue and FFMIA implementation generally, which may result in revision to OMB Bulletin No. 01-02 and additional guidance in the FAM.
- .64 If the auditor finds lack of substantial compliance with any of the three requirements, see section 595 B for reporting guidance; the lack of substantial compliance should be discussed in the significant matters section of the audit report. Frequently, lack of substantial compliance is related to material weaknesses or other reportable conditions in internal control. If so, the discussion should be combined in the significant matters section to avoid redundancy.
- .65 If the the auditor finds that the entity's systems did not substantially comply with the requirements, the auditor is required by FFMIA to identify the entity or organization responsible for the systems found not to comply; include pertinent facts, including nature and extent of the noncompliance, areas in which there is substantial but not full compliance, primary reason or cause, and any relevant comments from management or responsible employees; and make recommendations of remedial actions and time frames for implementing the recommendations. This information also should be included in the significant matters section and/or a recommendation section, if either is used.

**Scope of Procedures**

- .66 If the auditor is unable to perform all the procedures considered necessary, as discussed in section 350, the scope of the audit is restricted. Generally, if the scope of the audit is restricted, such as due to unavailability of needed information from the system, the auditor reports that the financial management systems are not in substantial compliance with FFMIA

requirements. Also, if the auditor concluded the systems were not in substantial compliance with FFMIA based on limited testing, he or she should report that the work on FFMIA would not necessarily disclose all instances of lack of substantial compliance with FFMIA requirements. (See section 595 B.)

### **COMPLIANCE WITH LAWS AND REGULATIONS**

- .67 The auditor reports on the results of compliance testing and on compliance matters (including fraud—see section 540) coming to his or her attention during procedures other than compliance tests. The manner in which noncompliance is reported depends on the significance of the noncompliance and whether such noncompliance is material to the financial statements, as described below. The auditor should consult with OGC regarding conclusions on the entity's compliance with laws and regulations.
- .68 The following definitions and guidelines should be used for classifying noncompliance detected during the audit.
- **Reportable noncompliance** includes all matters coming to the auditor's attention except those that in the auditor's judgment, are clearly inconsequential.
  - **Material noncompliance** is reportable noncompliance in which a failure to comply with laws or regulations results in misstatements that are material to the financial statements. Any instances of material noncompliance should be described in the significant matters section of the audit report.
- .69 Reportable noncompliance, other than material noncompliance, should be described in the significant matters section of the auditor's report if, in the auditor's judgment, it is considered to be a significant matter that should be communicated to the entity head, OMB, and the Congress. Otherwise, the auditor should list the reportable noncompliance in the significant matters section or in the compliance section of the report. Related instances of noncompliance should be combined. Such noncompliance may be reported in detail in another report or in the management letter, and that other report or management letter should be referred to in the auditor's report. To the extent that any such noncompliance contributes to significant matters, it should be described in conjunction with the related significant matter.

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- .70 Noncompliance that does not meet the criteria for reportable noncompliance may be orally communicated to an appropriate level of entity management, or the auditor may determine that no further consideration is necessary. The auditor should document any oral communication in the workpapers.

Reporting on compliance tests

- .71 The auditor states directly whether any reportable noncompliance was detected during compliance tests. This type of direct statement is illustrated in section 595 A for a situation in which the compliance tests disclosed no reportable noncompliance. If reportable noncompliance is noted, the statement should be modified as shown in section 595 B, and the reportable noncompliance should be discussed in the significant matters section of the auditor's report according to the guidance in paragraphs 580.69-.70.
- .72 The AICPA, in SAS No. 87, states that a report on compliance with laws and regulations in which no opinion is issued is a by-product report, a report that provides a limited degree of assurance about compliance. When no opinion is issued, the report on compliance is not the primary objective of the engagement. SAS 87 states that the auditor should indicate the intended use of the compliance report because of the potential for misunderstanding related to a by-product report's limited degree of assurance. Because the distribution of government audit reports is not restricted, the reports should explain their limitations. (See section 595 A in the objectives, scope, and methodology section).

Scope of procedures

- .73 The auditor should be able to perform all of the procedures considered necessary to obtain sufficient evidence to report on compliance with laws and regulations. If the auditor is unable to perform all of the procedures for each of the significant provisions of laws and regulations, he or she may be able to report on the laws and regulations tested; however, the auditor should modify the report to alert the reader that not all of the laws that were considered necessary were tested. See section 595 B for report modifications.
- .74 If the scope limitation is so significant that the auditor believes that any statement could be misleading, he or she may omit it. Significant scope limitations should be described in the significant matters section of the auditor's report, and the auditor's report should be modified as described in

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section 595 B. The auditor should also consider the effect of such a scope limitation on the opinion on the financial statements.

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

**OTHER INFORMATION IN THE ACCOUNTABILITY REPORT**

- .76 As discussed in OMB Bulletin, *Form and Content of Agency Financial Statements*, certain other information is to be included in the annual financial statement. This information consists of MD&A (the overview of the reporting entity), required supplementary information including RSSI, and other accompanying information.
- .77 GAAP require the reporting of certain RSSI: stewardship property, plant, and equipment (PP&E) and its condition (reported in units, including heritage assets, national defense PP&E, and stewardship land); stewardship investments (including nonfederal physical property, such as highways; human capital, such as expenditures for training and education; and research and development); risk-assumed information (such as pension and deposit insurance projections); and social insurance information. OMB and GAO, which are responsible for determining audit scope related to this information, do not require RSSI to be audited. RSSI presented should be marked "unaudited."
- .78 As this information is "required supplementary information," the auditor should apply procedures consistent with AU 558. As discussed in AU 558, the auditor should compare the consistency of the information with the financial statements and should discuss the methods of measurement and presentation with entity officials.
- .79 If there are no material inconsistencies or nonconformance with OMB guidance that come to the auditor's attention during these or other audit procedures, the auditor should state this as shown in section 595 A. (Although AU 558.08 requires reporting on the other information only if

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material inconsistencies or nonconformances with OMB guidance are found, OMB audit guidance requires the auditor to report based on AU 551.15.) If material inconsistencies or instances of nonconformance are noted and are not remedied by the entity, the auditor should describe these situations in the significant matters section of the auditor's report and refer to the discussion in the significant matters section as illustrated in section 595 B.

- .80 The auditor should also consider whether circumstances that resulted in modification of the auditor's report, such as a scope limitation or departure from GAAP, also affect this other information and disclose these effects in the discussion of those circumstances in the significant matters section of the report as described in section 595 B.
- .81 Following the objectives, scope, and methodology section of the report, there generally should be a section on agency comments. The auditor should allow the audited entity to review a draft of the report prior to issuance and provide either written or oral comments on it to assure the report is fair, objective, accurate, and complete. Written comments are generally preferred, especially when the report is sensitive or controversial, when significant disagreements exist, or when the report makes wide-ranging recommendations. Oral comments are preferred when there is a time-critical need to expedite issuance and the auditor has worked closely with the agency so that it is familiar with the findings and issues addressed in the draft, which are not expected to cause disagreements or controversy. If the report is unqualified, the entity may decide not to comment on it. The auditor should briefly characterize the overall response to the draft and summarize the major points made in the comments, whether written or oral, in the final section of the report. If agency officials concurred with all the findings, conclusions, and recommendations, the auditor should state that they concurred, mention actions the agency has agreed to take, and provide responses the auditor has to those actions. If agency officials disagree with or have concerns regarding portions of the report, the auditor should discuss these concerns fully and provide the auditor's response to them. Written comments generally should be included as an appendix to the report if they relate to the message.

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## Reporting Phase

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### 590 - DOCUMENTATION

- .01 The auditor should document the nature and extent of work performed in the reporting phase and the related conclusions. Such documentation should include
- evaluation of misstatements,
  - inquiries of attorneys,
  - subsequent events,
  - management representations,
  - related party transactions, and
  - procedures performed to determine consistency of the other information in the Accountability Report with the financial statements and on conformity with OMB guidelines on form and content of financial statements.

#### SPECIFIC DOCUMENTATION CONSIDERATIONS

##### Audit Summary Memorandum

- .02 At the completion of the audit, an audit summary memorandum should be prepared that summarizes the audit results and demonstrates the adequacy of the audit procedures and the reasonableness of the conclusions on the financial statements, internal control, substantial compliance of the financial management systems with the FFMIA requirements, the entity's compliance with laws and regulations, MD&A (the overview of the entity), required supplementary information (including RSSI), and other accompanying information.
- .03 The audit summary memorandum generally should refer to other workpapers where this information is described in more detail. The memorandum should briefly summarize and allow the reader to easily refer in the workpapers to
- any significant changes from the auditor's original assessment of the control environment, risk assessment, communication, and monitoring or inherent or control risks and significant revisions of audit procedures;
  - additional fraud risk factors or other conditions (beyond those considered in planning—section 260) identified during the audit that caused the

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**Reporting Phase**  
**590 - Documentation**

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auditor to believe that an additional response was required and any further response that the auditor concluded was appropriate;

- significant accounting, auditing, or reporting issues;
- any limitations on the audit scope and the auditor's assessment of whether the audit procedures were adequate to support conclusions on the financial statements, internal control, the systems' substantial compliance with FFMIA requirements, compliance with laws and regulations, MD&A, required supplementary information (including RSSI), and other accompanying information;
- the auditor's conclusions on whether the audit evidence obtained supports the conclusions on the financial statements, internal control, the systems' substantial compliance with FFMIA requirements, compliance with laws and regulations, MD&A, required supplementary information (including RSSI), and other accompanying information;
- the auditor's conclusion on whether the audit was done in compliance with GAGAS, OMB audit guidance, and the *GAO/PCIE Financial Audit Manual* and whether the report is appropriate;
- the auditor's conclusion on whether the entity's financial statements comply with generally accepted accounting principles;
- significant subsequent events, if any;
- the Summary of Unadjusted Misstatements;
- a summary of internal control weaknesses and a comparison of those the auditor found to the weaknesses reported in management's assertion about the effectiveness of internal control;
- a summary of instances of lack of substantial compliance with FFMIA requirements, including areas in which there is substantial but not full compliance;
- a summary of instances of noncompliance with laws and regulations; and
- the documentation of overall analytical procedures.



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**590 - Documentation**

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Overall Analytical Procedures

- .04 The following items should be documented in the workpapers for overall analytical procedures:
- **Data used and sources of data:** The documentation on the specific financial data used for the current-year amounts and the data used for comparison should include the amounts of the financial items; the dates or periods covered by the data; whether the data were audited or unaudited; the persons from whom the data were obtained, if applicable; and the source of the information (e.g., the general ledger trial balance, prior-year audit workpapers, or prior-year financial statements).
  - **Parameters for identifying significant fluctuations:** These parameters are left to the auditor's judgment.
  - **Explanations for significant fluctuations and sources of these explanations:** Explanations obtained should be consistent with corroborating evidence in the workpapers and should be referenced to this work.
  - **Auditor's conclusions on the results of the procedures:** The auditor's conclusions on the results of overall analytical procedures generally should be documented in the reporting phase workpapers.

Considering Weaknesses in Internal Control

- .05 The basis for considering internal control weaknesses as material weaknesses, other reportable conditions, or as not reportable, should be documented in the workpapers. Any oral communications of control weaknesses that are not included in a written report should be documented in the workpapers. Procedures performed to determine the effects of misstatements and weaknesses in internal control on other reports prepared and used by the entity also should be documented.

Reporting Lack of Substantial Compliance With FFMIA Requirements

- .06 The basis for considering whether noncompliances with FFMIA requirements represent lack of substantial compliance should be documented in the workpapers.

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**Reporting Phase**  
**590 - Documentation**

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Reporting Instances of Noncompliance

- .07 The basis for classification of instances of noncompliance as material noncompliance, other reportable noncompliance, or as not reportable should be documented in the workpapers. Any oral communications of noncompliance that are not included in a written report should be documented in the workpapers.

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## Reporting Phase

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### 595 A - EXAMPLE AUDITOR'S REPORT - UNQUALIFIED

In our audit of [name of entity] for fiscal year [year], we found

- the financial statements are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles,
- [entity] had effective internal control over financial reporting (including safeguarding assets) and compliance with laws and regulations,<sup>1</sup>
- [FFMIA reporting, see note 2 below],<sup>2</sup> and
- no reportable noncompliance with laws and regulations we tested.

The following sections discuss in more detail (1) these conclusions and our conclusions on Management's Discussion and Analysis and other supplementary information and (2) the scope of our audit.

#### Opinion on Financial Statements

The financial statements including the accompanying notes present fairly, in all material respects, in conformity with U.S. generally accepted accounting principles, [name of entity's] assets, liabilities, and net position; net costs; changes in net position; budgetary resources; reconciliation of net costs to

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<sup>1</sup> If the auditor does not express an opinion on internal control, the following should replace the second bullet:

- "● no material weaknesses in internal control over financial reporting (including safeguarding assets) and compliance with laws and regulations,"

<sup>2</sup> Specific guidance for FFMIA reporting will be provided in the future. OMB and GAO are reviewing this reporting issue and FFMIA implementation generally, which may result in revision to OMB Bulletin No. 01-02 and additional guidance in the FAM.

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**Reporting Phase**  
**595 A - Example Auditor's Report - Unqualified**

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budgetary obligations; and custodial activity (if applicable)<sup>3</sup> as of September 30, 20XX and for the year then ended.

Opinion on Internal Control<sup>4</sup>

[Entity] maintained, in all material respects, effective internal control over financial reporting (including safeguarding assets) and compliance as of [end of fiscal year] that provided reasonable assurance that misstatements, losses, or noncompliance material in relation to the financial statements or to stewardship information would be prevented or detected on a timely basis. Our opinion is based on criteria established under 31 U.S.C. 3512 (c), (d), the Federal Managers' Financial Integrity Act, and the Office of Management

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<sup>3</sup> This list assumes the entity follows GAAP issued by FASAB. If the entity follows GAAP issued by FASB (government corporations and others such as the U.S. Postal Service), modify the list accordingly.

<sup>4</sup> If the auditor does not express an opinion on internal control, this section should be replaced with the following:

"Consideration of Internal Control

"In planning and performing our audit, we considered [entity's] internal control over financial reporting and compliance. [Here the auditor should include a footnote stating the objectives of internal control, which are reasonable assurance that the two bullets in the objectives, scope, and methodology section are achieved.] We did this to determine our procedures for auditing the financial statements and to comply with OMB audit guidance, not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting and compliance. However, for the controls we tested, we found no material weaknesses in internal control over financial reporting (including safeguarding assets) and compliance. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that errors, fraud, or noncompliance in amounts that would be material to the financial statements may occur and not be detected promptly by employees in the normal course of performing their duties. Our internal control work would not necessarily disclose all material weaknesses."

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**Reporting Phase**  
**595 A - Example Auditor's Report - Unqualified**

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and Budget (OMB) Circular A-123, *Management Accountability and Control* [or other criteria].

Systems' Compliance With FFMIA Requirements<sup>5</sup>

Compliance With Laws and Regulations

Our tests for compliance with selected provisions of laws and regulations disclosed no instances of noncompliance that would be reportable under U.S. generally accepted government auditing standards or OMB audit guidance. However, the objective of our audit was not to provide an opinion on overall compliance with laws and regulations. Accordingly, we do not express such an opinion.

Consistency of Other Information

Management's Discussion and Analysis, required supplementary information (including stewardship information), and other accompanying information contain a wide range of data, some of which are not directly related to the financial statements. We do not express an opinion on this information. However, we compared this information for consistency with the financial statements and discussed the methods of measurement and presentation with [name of entity] officials. Based on this limited work, we found no material inconsistencies with the financial statements or nonconformance with OMB guidance.

Objectives, Scope, and Methodology

Management is responsible for (1) preparing the financial statements in conformity with generally accepted accounting principles, (2) establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act are met, (3) ensuring that [entity's] financial management

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<sup>5</sup> See footnote 2.

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**Reporting Phase**  
**595 A - Example Auditor's Report - Unqualified**

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systems substantially comply with FFMIA requirements, and (4) complying with applicable laws and regulations.

We are responsible for obtaining reasonable assurance about whether (1) the financial statements are presented fairly, in all material respects, in conformity with generally accepted accounting principles and (2) management maintained effective internal control, the objectives of which are the following:<sup>6</sup>

- Financial reporting: Transactions are properly recorded, processed, and summarized to permit the preparation of financial statements and stewardship information in conformity with generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition.
- Compliance with laws and regulations: Transactions are executed in accordance with laws governing the use of budget authority and with other laws and regulations that could have a direct and material effect on the financial statements and any other laws, regulations, and governmentwide policies identified by OMB audit guidance.

We are also responsible for<sup>7</sup> (1) testing whether [entity's] financial management systems substantially comply with the three FFMIA requirements, (2) testing compliance with selected provisions of laws and regulations that have a direct and material effect on the financial statements and laws for which OMB audit guidance requires testing, and (3) performing limited procedures with respect to certain other information appearing in the Accountability Report.

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<sup>6</sup> If the auditor does not express an opinion on internal control, delete the numbers in parentheses, put a period after "generally accepted accounting principles," and delete the rest of the sentence including the two bullets.

<sup>7</sup> If the auditor does not express an opinion on internal control, insert the following after the "for," "(1) obtaining a sufficient understanding of internal control over financial reporting and compliance to plan the audit," and renumber the following phrases.

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**Reporting Phase**  
**595 A - Example Auditor's Report - Unqualified**

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In order to fulfill these responsibilities, we (1) examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements, (2) assessed the accounting principles used and significant estimates made by management, (3) evaluated the overall presentation of the financial statements, (4) obtained an understanding of internal control related to financial reporting (including safeguarding assets), compliance with laws and regulations (including execution of transactions in accordance with budget authority), and performance measures reported in Management's Discussion and Analysis of the Accountability Report, (5) tested relevant internal controls over financial reporting, and compliance, and evaluated the design and operating effectiveness of internal control, (6) considered the process for evaluating and reporting on internal control and financial management systems under the Federal Managers' Financial Integrity Act, (7) tested whether [entity's] financial management systems substantially complied with the three FFMIA requirements, and (8) tested compliance with selected provisions of the following laws and regulations [list laws and regulations].

We did not evaluate all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to controls over financial reporting and compliance. Because of inherent limitations in internal control, misstatements due to error or fraud, losses, or noncompliance may nevertheless occur and not be detected. We also caution that projecting our evaluation to future periods is subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with controls may deteriorate.<sup>8</sup>

We did not test compliance with all laws and regulations applicable to [entity]. We limited our tests of compliance to those laws and regulations required by OMB audit guidance that we deemed applicable to the financial statements for the fiscal year ended [date]. We caution that noncompliance may occur and not be detected by these tests and that such testing may not be sufficient for other purposes.

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<sup>8</sup> If the auditor does not express an opinion on internal control, add at the end of this paragraph, "In addition, we caution that our internal control testing may not be sufficient for other purposes."

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**Reporting Phase**  
**595 A - Example Auditor's Report - Unqualified**

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We performed our work in accordance with U.S. generally accepted government auditing standards and OMB audit guidance.

Agency Comments and Our Evaluation

In commenting on a draft of this report (see appendix x), [entity] concurred with the facts and conclusions in our report.



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## Reporting Phase

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### 595 B - SUGGESTED MODIFICATIONS TO AUDITOR'S REPORT

This section suggests how to modify each major section of the unqualified auditor's report on the Accountability Report (annual financial statement) illustrated in section 595 A for each of the situations listed below.

	<u>Page</u>
<b>Situations relating to the financial statements:</b>	
1. Scope limitation resulting in a qualified opinion on the financial statements	595 B-3
2. Scope limitation resulting in a disclaimer of an opinion on the financial statements	595 B-3
3. Uncertainty resulting in the addition of an explanatory paragraph	595 B-4
4. Lack of consistency in the application of accounting principles resulting in the addition of an explanatory paragraph	595 B-4
5. Departure from generally accepted accounting principles resulting in a qualified opinion on the financial statements	595 B-5
6. Departure from generally accepted accounting principles resulting in an adverse opinion on the financial statements	595 B-5
<b>Situations relating to internal control:</b>	
7. Scope limitation resulting in a disclaimer of opinion on internal control	595 B-6
8. Scope limitation resulting in a qualified opinion on internal control	595 B-7
9. Material weaknesses in internal control	595 B-9
10. Reportable conditions (other than material weaknesses) in internal control	595 B-12
11. The purpose was not to give an opinion on internal and other reportable conditions were found	595 B-14
12. The purpose was not to give an opinion on internal control and one or a few material weaknesses were found	595 B-16

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**Reporting Phase**  
**595 B - Suggested Modifications to Auditor's Report**

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13. The purpose was not to give an opinion on internal control and many material weaknesses were found 595 B-18

**Situations relating to financial management systems' substantial compliance with FFMIA requirements:**

14. Lack of financial management systems' substantial compliance with FFMIA requirements 595 B-20

**Situations relating to compliance with laws and regulations:**

15. Scope limitation—some laws and regulations could not be tested 595 B-21

16. Scope limitation—all laws and regulations could not be tested—disclaimer 595 B-22

17. Material noncompliance with laws and regulations 595 B-23

18. Reportable noncompliance (other than material noncompliance) with laws and regulations 595 B-24

**Situations relating to the consistency of other information in the Accountability Report (management' discussion and analysis (or overview), required supplementary information (including stewardship information), and other accompanying information):**

19. Material inconsistency between other information and the principal statements 595 B-26

20. Nonconformance of other information with OMB guidance 595 B-27

21. Any situation that caused the auditor to modify the report on the financial statements, internal control, or compliance with laws and regulations that also affects other information 595 B-28

**Reporting Phase**  
**595 B - Suggested Modifications to Auditor's Report**

Financial Statements				
Situation	Introduction	Significant Matters (see note 1)	Opinion or Conclusion	Objectives, Scope, and Methodology
1. Scope limitation—qualified opinion (see paragraph 580.14)	First bullet: "Evidence about [identify account(s) affected by the scope limitation] in the financial statements was not available because of limitations on the scope of our work. Otherwise, we found the financial statements are presented fairly in conformity with generally accepted accounting principles."	Describe significant limitations on the scope of the work.	"Qualified Opinion on Financial Statements "Because of the limitation on the scope of our work described above, we cannot determine if the financial statements' presentation of [identify account(s) affected by the scope limitation] is free of material misstatement. Otherwise, the financial statements including the accompanying notes present fairly ..."	After the last sentence add: "We considered the limitations on the scope of our work in forming our conclusions."
2. Scope limitation—disclaimer (see paragraph 580.14)	First bullet: "We are unable to give an opinion on the fiscal year [year] financial statements of [name of entity] because of limitations on the scope of our work. Thus, the financial statements may be unreliable."	Describe scope limitations that caused the disclaimer of the opinion and conclude with the following statement: "Because of this limitation on the scope of our work, we are unable to give an opinion on the financial statements."	"Disclaimer of Opinion on Financial Statements "As described above, we are unable to give an opinion on the financial statements."	Because we did not audit the financial statements, delete all references to the auditor's responsibility for auditing the financial statements and how that responsibility was fulfilled. (See note 2.)

**Reporting Phase**  
**595 B - Suggested Modifications to Auditor's Report**

Financial Statements				
Situation	Introduction	Significant Matters (see note 1)	Opinion or Conclusion	Objectives, Scope, and Methodology
3. Uncertainty— explanatory paragraph (see paragraph 580.19)	No changes.	No changes.  (See note 7.)	Opinion on Financial Statements (see note 7): After the opinion, include an explanatory paragraph describing the uncertainty.	No changes.
4. Lack of consistency in the application of accounting principles— explanatory paragraph (see paragraph 580.20)	No changes.	No changes.  (See note 7.)	Opinion on Financial Statements (see note 7): After the opinion, include an explanatory paragraph explaining the accounting change. For example: "As discussed in Note X to the financial statements, the entity changed its method of computing depreciation in fiscal year [year]."	No changes.

**Reporting Phase**  
**595 B - Suggested Modifications to Auditor's Report**

Financial Statements				
Situation	Introduction	Significant Matters (see note 1)	Opinion or Conclusion	Objectives, Scope, and Methodology
5. Departure from GAAP—qualified opinion (see paragraph 580.22)	First bullet: "Entity departed from generally accepted accounting principles in [identify account(s) affected by the departure from GAAP]. Otherwise the financial statements are presented fairly in conformity with generally accepted accounting principles."	Describe material departures from GAAP.	"Qualified Opinion on Principal Statements "Except for the departure from U.S. generally accepted accounting principles described above, the financial statements, including the accompanying notes, present fairly ..."	No changes.
6. Departure from GAAP—adverse opinion (see paragraph 580.22)	First bullet: "The financial statements are not presented fairly in conformity with generally accepted accounting principles."	Describe material departures from GAAP.	"Adverse Opinion on Financial Statements "Because of the departure from U.S. generally accepted accounting principles described above, the financial statements, including the accompanying notes, do not present fairly ..."	No changes.

**Reporting Phase**  
**595 B - Suggested Modifications to Auditor's Report**

Internal Control				
Situation	Bullets	Significant Matters (see note 1)	Opinion or Conclusion	Objectives, Scope, and Methodology
7. Scope limitation—disclaimer (see paragraph 580.39)	Second bullet: "We are unable to give an opinion on internal control because of limitations on the scope of our work."	Describe limitations on the scope of work that caused the disclaimer of the opinion and conclude with the following statement: "Because of this limitation on the scope of our work, we are unable to give an opinion on internal control."	"Disclaimer of Opinion on Internal Control "As described above, we are unable to give an opinion on internal control."	Because we did not perform adequate procedures to give an opinion on internal control, delete all references to the auditor's responsibility for giving such an opinion and how that responsibility was fulfilled. (See note 3.)

**Reporting Phase**  
**595 B - Suggested Modifications to Auditor's Report**

Internal Control				
Situation	Bullets	Significant Matters (see note 1)	Opinion or Conclusion	Objectives, Scope, and Methodology
<p>8. Scope limitation on one objective—qualified opinion (see paragraph 580.39)</p> <p>(continued on next page)</p>	<p>Second bullet:            "We are unable to give an opinion on internal control over [state objective affected, for example, financial reporting] because of limitations on the scope of our work. We found that management had effective internal control over [state objective not affected, for example, compliance with laws and regulations.]"</p>	<p>Describe significant limitations on the scope of the work. This should follow the discussion of a scope restriction on the audit of the financial statements, if any, and should conclude with the following statement:            "Because of this limitation on the scope of our work, we are unable to give an opinion on internal control over [state the affected control objective, such as financial reporting]."</p>	<p>"Qualified Opinion on Internal Control            "As described above, we are unable to give an opinion on internal control over [state control objective affected]. However, we did evaluate internal control over [list control objective not affected by scope limitation]."</p> <p>State the opinion on the other objective:              (continued on next page)</p>	<p>After the last sentence add:            "We considered the limitations on the scope of our work in forming our conclusions."</p>

**Reporting Phase**  
**595 B - Suggested Modifications to Auditor's Report**

Internal Control				
Situation	Bullets	Significant Matters (see note 1)	Opinion or Conclusion	Objectives, Scope, and Methodology
<p>8. Scope limitation on one objective—qualified opinion (see paragraph 580.39)</p> <p>(continued from previous page)</p>			<p>"[Entity] maintained in all material respects effective internal control over [list unaffected areas, for example, financial reporting or compliance] as of [end of fiscal year] that provided reasonable assurance that [list unaffected areas, for example, misstatements and losses or noncompliance] material in relation to the financial statements or to stewardship information would be prevented or detected on a timely basis. Our opinion is based on... [continue with second sentence].</p>	



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Internal Control				
Situation	Bullets	Significant Matters (see note 1)	Opinion or Conclusion	Objectives, Scope, and Methodology
<p>9. Material weakness in internal control relevant to one or more control objective(s) (see paragraph 580.43)</p> <p>(continued on next page)</p>	<p>Second bullet:  "[Entity] did not have effective internal control over [state objective(s) affected, for example, financial reporting], but had effective internal control over [state objective not affected, for example, compliance with laws and regulations]."</p>	<p>Describe material weaknesses in internal control and include the term "material weakness" in the description. Indicate whether each weakness was reported by management in FMFIA reports.</p> <p>Add the following to address the possible effects of material weaknesses on other reports:  "These deficiencies in internal control may adversely affect any decision by management that is based, in whole or in part, on information that is inaccurate because of the deficiencies.</p> <p>(continued on next page)</p>	<p>"Adverse Opinion on Internal Control</p> <p>"Because of the material weakness(es) in internal control described above, [entity] did not maintain effective internal control over [state objective(s) affected, for example, financial reporting or compliance] as of [end of fiscal year], which thus did not provide reasonable assurance that [state control objective(s) affected, such as misstatements and losses or noncompliance] material in relation to the financial statements or to stewardship information would be prevented or detected on a timely basis."</p> <p>(continued on next page)</p>	<p>No changes unless both control objectives are affected by material weakness(es). In that situation, delete the sentences of caution on projection of the evaluation of controls to future periods that begins: "Because of inherent limitations [delete rest of paragraph]..."</p>

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Internal Control				
Situation	Bullets	Significant Matters (see note 1)	Opinion or Conclusion	Objectives, Scope, and Methodology
<p>9. Material weakness in internal controls relevant to one or more control objective(s) (see paragraph 580.43)</p> <p>(continued from previous page)</p> <p>(continued on next page)</p>		<p>Unaudited financial information reported by [name of entity], including budget information, also may contain misstatements resulting from these deficiencies."</p>	<p>If controls were effective over one objective, add the following:            "However, [entity] maintained in all material respects effective internal control over [state objective not affected, such as compliance or financial reporting] as of [date of fiscal year-end] that provided reasonable assurance that [state appropriate effect(s) such as, noncompliance or misstatements and losses] material in relation to the financial statements or to stewardship information would be prevented or detected on a timely basis."            Continue with sentence about the basis of the opinion.</p> <p>(continued on next page)</p>	

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Internal Control				
Situation	Bullets	Significant Matters (see note 1)	Opinion or Conclusion	Objectives, Scope, and Methodology
<p>9. Material weakness in internal control relevant to one or more control objective(s) (see paragraph 580.43)</p> <p>(continued from previous page)</p>			<p>Opinion on Financial Statements:            If the opinion on financial statements is unqualified, include the following at the end of the opinion on the financial statements:            "However, misstatements may nevertheless occur in other financial information reported by [name of entity] as a result of the internal control weakness(es) described above."</p> <p>If the report also includes reportable conditions other than material weaknesses, see note 6.</p>	

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Internal Control				
Situation	Bullets	Significant Matters (see note 1)	Opinion or Conclusion	Objectives, Scope, and Methodology
<p>10. Reportable conditions (other than material weaknesses) (see paragraph 580.46)</p> <p>(continued on next page)</p>	<p>Second bullet:            "Although internal controls should be improved, [entity] had effective internal control over ..."</p>	<p>For reportable conditions considered to be significant matters that should be communicated to the entity head, OMB, and the Congress (as defined in paragraph 580.52):</p> <p>Describe the weaknesses and indicate (1) that the weaknesses are not material weaknesses and (2) whether the weaknesses were reported by management in the summary of FMFIA reports.</p> <p>(continued on next page)</p>	<p>Opinion on Internal Control:            No change to the two sentences.            Following that, continue:            "However, our work identified the need to improve certain internal control, as described above and in [identify other reports or management letters that discuss these internal control weaknesses in more detail by reference to date and GAO document number]. These weaknesses in internal control, although not considered to be material weaknesses, represent significant deficiencies in the design or operations of internal control, which could adversely affect the entity's ability to meet the internal control objectives listed above or meet OMB criteria for reporting matters under FMFIA."</p> <p>(continued on next page)</p>	<p>No changes.</p>

**Reporting Phase**  
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Internal Control				
Situation	Bullets	Significant Matters (see note 1)	Opinion or Conclusion	Objectives, Scope, and Methodology
<p>10. Reportable conditions (other than material weaknesses) (see paragraph 580.46)</p> <p>(continued from previous page)</p>		<p>For reportable conditions that are not considered to be significant matters individually (as defined in paragraph 580.52):</p> <ul style="list-style-type: none"> <li>List the weaknesses.</li> <li>Combine related weaknesses.</li> </ul>	<p>If reportable conditions are included as significant matters and the opinion on the financial statements is unqualified, include the following:</p> <p>"In addition, misstatements may occur in other financial information reported by [name of entity] as a result of the internal control weakness(es) described above."</p> <p>If the report also includes material weaknesses, see note 6.</p>	

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Internal Control				
Situation	Bullets	Significant Matters (see note 1)	Opinion or Conclusion	Objectives, Scope, and Methodology
<p>11. The purpose was not to give an opinion on internal control and other reportable conditions were found (see paragraph 580.49)</p> <p>(continued on next page)</p>	<p>Second bullet:            "No material weaknesses in internal control over financial reporting (including safeguarding assets) and compliance and its operation, although internal control should be improved."</p>	<p>If reportable conditions considered to be significant matters that should be communicated to the entity head, OMB, and the Congress (as defined in paragraph 580.52) were found:            Describe the weaknesses and indicate (1) that the weaknesses are not material weaknesses and (2) whether the weaknesses were reported by management in the summary of FMFIA reports.</p> <p>(continued on next page)</p>	<p>"Consideration of Internal Control            "We considered internal control over financial reporting and compliance.</p> <p>"We do not express an opinion on internal control over financial reporting and compliance because the purpose of our work was to determine our procedures for auditing the financial statements and to comply with OMB audit guidance, not to express an opinion on internal control. However, our work identified the need to improve certain internal controls, as described above. These weaknesses in internal control, although not considered material weaknesses, represent significant deficiencies in the design or operation of internal control, which could adversely</p> <p>(continued on next page)</p>	<p>See note 8.</p>

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Internal Control				
Situation	Bullets	Significant Matters (see note 1)	Opinion or Conclusion	Objectives, Scope, and Methodology
<p>11. The purpose was not to give an opinion on internal control and other reportable conditions were found (see paragraph 580.49)</p> <p>(continued from previous page)</p>		<p>If reportable conditions are not considered to be significant matters individually (as defined in paragraph 580.52):            List the weaknesses.            Combine related weaknesses.</p>	<p>affect the entity's ability to meet the internal control objectives listed in the objectives, scope, and methodology or meet OMB criteria for reporting matters under FMFIA. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that errors, fraud, or noncompliance in amounts that would be material to the financial statements may occur and not be detected promptly by employees in the normal course of performing their duties. Our internal control work would not necessarily disclose all material weaknesses."</p>	

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Internal Control				
Situation	Bullets	Significant Matters (see note 1)	Opinion or Conclusion	Objectives, Scope, and Methodology
<p>12. The purpose was not to give an opinion on internal control and one or a few material weaknesses were found (see paragraph 580.49)</p> <p>(continued on next page)</p>	<p>Second bullet:            "Material weakness(es) over [briefly describe area affected by material weakness(es), for example, reporting expenditures]."</p>	<p>Describe material weaknesses found and include the term "material weakness" in the description. Indicate whether each weakness was reported by management in FMFIA reports.</p> <p>Add the following to address the possible effects of material weaknesses on other reports:            "These deficiencies in internal control may adversely affect any decision by management that is based, in whole or in part, on information that is inaccurate because of the deficiencies.</p> <p>(continued on next page)</p>	<p>"Consideration of Internal Control            "We considered internal control over financial reporting and compliance.</p> <p>"We do not express an opinion on internal control over financial reporting and compliance because the purpose of our work was to determine our procedures for auditing the financial statements and to comply with OMB audit guidance, not to express an opinion on internal control. However, we found the material weakness(es) described above. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that errors, fraud, or noncompliance in amounts that would be material to</p> <p>(continued on next page)</p>	<p>See note 8.</p>



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Internal Control				
Situation	Bullets	Significant Matters (see note 1)	Opinion or Conclusion	Objectives, Scope, and Methodology
<p>12. The purpose was not to give an opinion on internal control and one or a few material weaknesses were found (see paragraph 580.49)</p> <p>(continued from previous page)</p>		<p>Unaudited financial information reported by [name of entity], including budget information, also may contain misstatements resulting from these deficiencies."</p>	<p>the financial statements may occur and not be detected promptly by employees in the normal course of performing their duties. Our internal control work would not necessarily disclose all material weaknesses."</p>	

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Internal Control				
Situation	Bullets	Significant Matters (see note 1)	Opinion or Conclusion	Objectives, Scope, and Methodology
<p>13. The purpose was not to give an opinion on internal control and many material weaknesses were found (see paragraph 580.49)</p> <p>(continued on next page)</p>	<p>Second bullet:            "Material weaknesses in internal control that resulted in ineffective controls over [state objective(s) affected, for example, financial reporting]."</p>	<p>Describe material weaknesses found and include the term "material weakness" in the description. Indicate whether each weakness was reported by management in FMFIA reports.</p> <p>Add the following to address the possible effects of material weaknesses on other reports:            "These deficiencies in internal control may adversely affect any decision by management that is based, in whole or in part, on information that is inaccurate because of the deficiencies.</p> <p>(continued on next page)</p>	<p>"Consideration of Internal Control            "We considered internal control over financial reporting and compliance.</p> <p>"We do not express an opinion on internal control over financial reporting and compliance because the purpose of our work was to determine our procedures for auditing the financial statements and to comply with OMB audit guidance, not to express an opinion on internal control. However, we found the material weakness(es) described above, which resulted in ineffective controls over [state objective(s) affected, for example, financial reporting]. A material weakness is a condition in which the design or operation of one or more of the internal control components</p> <p>(continued on next page)</p>	<p>See note 8.</p>

**Reporting Phase**  
**595 B - Suggested Modifications to Auditor's Report**

Internal Control				
Situation	Bullets	Significant Matters (see note 1)	Opinion or Conclusion	Objectives, Scope, and Methodology
<p>13. The purpose was not to give an opinion on internal control and many material weaknesses were found (see paragraph 580.49)</p> <p>(continued from previous page)</p>		<p>Unaudited financial information reported by [name of entity], including budget information, also may contain misstatements resulting from these deficiencies."</p>	<p>does not reduce to a relatively low level the risk that errors, fraud, or noncompliance in amounts that would be material to the financial statements may occur and not be detected promptly by employees in the normal course of performing their duties. Our internal control work would not necessarily disclose all material weaknesses."</p>	

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Financial Management Systems' Substantial Compliance with FFMIA Requirements				
Situation	Bullets	Significant Matters (see note 1)	Opinion or Conclusion	Objectives, Scope, and Methodology
14. Lack of financial management systems' substantial compliance with FFMIA requirements (see paragraph 580.64)	Third bullet: "[entity's] financial management systems did not substantially comply with the requirements of FFMIA."	Describe instances of lack of substantial compliance of financial management systems with federal financial management systems requirements, federal accounting standards, or the SGL at the transaction level. Indicate whether each instance was reported by management in FMFIA reports. In addition, as required by FFMIA, identify the entity or organization responsible for the systems found not to comply; include the nature and extent of the noncompliance, areas in which there was substantial but not full compliance, primary reason or cause, and relevant management comments; and make recommendations (in the recommendation section) and set time frames for implementing recommendations.	Systems' Compliance With FFMIA Requirements: "Our work disclosed instances, described above, in which [entity's] financial management systems did not substantially comply with [specify the requirements where a lack of substantial compliance was found, such as federal financial management systems requirements or the <i>U.S. Government Standard General Ledger</i> at the transaction level]."  See section 595A, footnote 2, re reporting on other requirements.	Add: "Our work on FFMIA would not necessarily disclose all instances of lack of substantial compliance with FFMIA requirements."

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Compliance with Laws and Regulations				
Situation	Bullets	Significant Matters (see note 1)	Opinion or Conclusion	Objectives, Scope and Methodology
15. Scope limitation —some laws could not be tested (see paragraph 580.73)	Fourth bullet: "No reportable noncompliance with laws and regulations we tested; however, we could not test compliance with certain laws we considered necessary because of limitations on the scope of our work."	Describe significant scope limitations, including a list of the laws not tested.	"Compliance With Laws and Regulations: "Our tests for compliance with selected provisions of laws and regulations disclosed no instances of noncompliance that would be reportable under U.S. generally accepted government auditing standards or OMB audit guidance; however, as discussed above, we could not test for compliance with all the laws we considered necessary."	Exclude laws not tested from list of laws.  After the last sentence add: "We considered the limitations on the scope of our work in forming our conclusions."

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Compliance with Laws and Regulations				
Situation	Bullets	Significant Matters (see note 1)	Opinion or Conclusion	Objectives, Scope and Methodology
16. Scope limitation —all laws could not be tested— disclaimer (see paragraph 580.73)	Fourth bullet: "We were unable to test [entity's] compliance with laws and regulations because of limitations on the scope of our work."	Describe scope limitation. Conclude with: "Because of this limitation on the scope of our work, we were unable to test [entity's] compliance with laws and regulations."	Compliance With Laws and Regulations: Omit statement regarding compliance with laws and regulations. Replace with: "We were unable to test for compliance with the laws we considered necessary; accordingly, we are unable to report on the entity's compliance with laws and regulations." Omit the last two sentences.	Delete all references to the auditor's responsibility for testing compliance with laws and regulations and how that responsibility was fulfilled. (See note 4.)

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Compliance with Laws and Regulations				
Situation	Bullets	Significant Matters (see note 1)	Opinion or Conclusion	Objectives, Scope and Methodology
17. Material noncompliance with laws and regulations (see paragraph 580.68)	Fourth bullet: "Reportable noncompliance with laws and regulations we tested."	Describe the material noncompliance and place the findings in proper perspective to give readers a basis for judging the prevalence and consequences of the conditions. Although it is not necessary to use the word "material," a fuller description is necessary than for reportable noncompliance that is not material.	Compliance with Laws and Regulations: "Except as noted above, our tests for compliance with the provisions of selected laws and regulations disclosed no other instances of noncompliance that would be reportable under U.S. generally accepted government auditing standards or OMB audit guidance." [Continue paragraph with last two sentences.]	No changes.

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Compliance with Laws and Regulations				
Situation	Bullets	Significant Matters (see note 1)	Opinion or Conclusion	Objectives, Scope and Methodology
18. Reportable noncompliance (other than material noncompliance) (see paragraph 580.69)	Fourth bullet: "Reportable noncompliance with laws and regulations we tested."	<p>For noncompliance that is considered to be a significant matter that should be communicated to the entity head, OMB, and the Congress:  Describe the noncompliance. Indicate that the noncompliance is not material to the financial statements.</p> <p>For reportable noncompliance that is not considered to be significant:  List the noncompliance. Combine related instances of noncompliance.</p>	<p>Compliance With Laws and Regulations:  "Except as noted above, our tests for compliance with selected provisions of laws and regulations disclosed no other instances of noncompliance that would be reportable under U.S. generally accepted government auditing standards or OMB audit guidance." [Continue paragraph with last two sentences.]</p>	No changes.



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Consistency of Other Information (MD&A (Overview), Required Supplementary Information (including Stewardship Information), and Other Accompanying Information)				
Situation	Introduction	Significant Matters (see note 1)	Opinion or Conclusions	Objectives, Scope, and Methodology
19. Material inconsistency between other information and financial statements (see paragraph 580.79)	No changes.	Describe material inconsistency.	<p>Consistency of other information: Omit statement that we found no material inconsistencies. Add: "As discussed above, the [list type(s) of other information in the Accountability Report (or annual financial statement)—MD&amp;A (or overview), required supplementary information (including stewardship information), other accompanying information—that is not consistent with the financial statements] is inconsistent with the financial statements."</p> <p>If certain type(s) of information are consistent, add: "Otherwise, we found no other material inconsistencies with the financial statements and the [state type(s) of information not affected] or nonconformance with OMB guidance."</p>	No changes.

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Consistency of Other Information (MD&A (Overview), Required Supplementary Information (including Stewardship Information), and Other Accompanying Information)				
Situation	Introduction	Significant Matters (see note 1)	Opinion or Conclusions	Objectives, Scope, and Methodology
20. Nonconformance of other information with OMB guidance (see paragraph 580.79)	No changes.	Describe nonconformance with OMB guidance.	<p>Consistency of other information: Omit statement that we found no nonconformance with OMB guidance. Add:</p> <p>"As discussed above, the [list the type(s) of other information in the Accountability Report (or annual financial statement)—MD&amp;A (or overview), required supplementary information, or other accompanying information—that is not in conformity] does not conform with OMB guidance."</p> <p>If certain type(s) of other information conforms to OMB guidance, add:</p> <p>"Otherwise, we found no other material inconsistencies with the financial statements or nonconformance of the [state type(s) of information not affected] with OMB guidance."</p>	No changes.

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Consistency of Other Information (MD&A (Overview), Required Supplementary Information (including Stewardship Information), and Other Accompanying Information)				
Situation	Introduction	Significant Matters (see note 1)	Opinion or Conclusions	Objectives, Scope, and Methodology
21. Any situation that caused the auditor to modify the report on the financial statements, internal control, or compliance with laws and regulations that also affects other information (see paragraph 580.80)	No changes.	In the discussion of the situation, include the effects on the other information in the Accountability Report.	<p>Consistency of other information:            Omit statement that we found no inconsistency or nonconformance (or modify to refer only to unaffected type(s) of other information in the Accountability Report—MD&amp;A (overview), required supplementary information, or other accompanying information ) if considered to be misleading in light of the particular situation.</p> <p>Omit statement that we found no inconsistencies or nonconformance if there is a scope limitation that resulted in a disclaimer of a report on the financial statements.</p>	If a scope limitation on the work on the principal statements, internal control, or compliance with laws and regulations results in the omission of the statement that we found no inconsistency of other information, delete all references to the auditor's responsibility for this other information and how we fulfilled that responsibility. (See note 5.)

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## Reporting Phase

### 595 B - Suggested Modifications to Auditor's Report

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#### Note 1: Significant matters

If a significant matters section is included in the auditor's report, add the following statement in quotation marks to the introduction immediately preceding "The following sections describe...":

"Described below are significant matters considered in performing our audit and forming our conclusions."

#### Note 2: Disclaimer due to a scope limitation on financial statements

In the "Objectives, Scope and Methodology" section delete the following words in quotation marks.

We are responsible for obtaining reasonable assurance about whether "(1)the financial statements are presented fairly, in all material respects, in conformity with generally accepted accounting principles], and (2)" [continue with rest of paragraph].

Delete the following:

- " (1) examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements,
- (2) assessed the accounting principles used and significant estimates made by management,
- (3) evaluated the overall presentation of the financial statements,"

Add the following words in quotation marks:

We performed our work in accordance with U.S. generally accepted government auditing standards and OMB audit guidance. "We considered the limitations on the scope of our work in forming our conclusions."

#### Note 3: Disclaimer of opinion on internal control due to a scope limitation

In the "Objectives, Scope, and Methodology" section, delete the following words in quotations marks:

We are responsible for obtaining reasonable assurance about whether "(1)" the financial statements are presented fairly, in all material respects, in conformity with generally accepted accounting principles "and (2) management maintained effective internal control, the objectives of which are the following:

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**Reporting Phase**  
**595 B - Suggested Modifications to Auditor's Report**

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- Financial reporting: Transactions are properly recorded, processed, and summarized to permit the preparation of financial statements and stewardship information in conformity with generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition.
- Compliance with laws and regulations: Transactions are executed in accordance with laws governing the use of budget authority and with other laws and regulations that could have a direct and material effect on the financial statements and any other laws, regulations, and governmentwide policies identified by OMB audit guidance." [continue with rest of paragraph]

Delete the following:

- " (4) obtained an understanding of internal control related to financial reporting (including safeguarding assets), compliance with laws and regulations (including execution of transactions in accordance with budget authority), and performance measures reported in Management's Discussion and Analysis (or the overview) of the Accountability Report;
- (5) tested relevant internal controls over financial reporting (including safeguarding assets), compliance, and evaluated the design and operating effectiveness of internal control;
- (6) considered the process for evaluating and reporting on internal control and financial management systems under the Federal Managers' Financial Integrity Act of 1982," ...[continue with rest of paragraph]

"We did not evaluate all internal controls relevant to operating objectives as broadly defined by FMFIA, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to those controls over financial reporting and compliance. Because of inherent limitations in internal control, misstatements due to error or fraud, losses, or noncompliance may nevertheless occur and not be detected. We also caution that projecting our evaluation to future periods is subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with controls may deteriorate."

Add the following words in quotation marks:

We performed our work in accordance with U.S. generally accepted government auditing standards and OMB audit guidance. "We considered the limitations on the scope of our work in forming our conclusions."

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### 595 B - Suggested Modifications to Auditor's Report

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Note 4: Disclaimer of a report on compliance with laws and regulations due to a scope limitation

In the objectives, scope and methodology section, delete the following words in quotation marks:

We are also responsible for "(1)" testing whether [entity's] financial management systems substantially comply with the three FFMIA requirements, "(2) testing compliance with selected provisions of laws and regulations that have a direct and material effect on the financial statements and laws for which OMB audit guidance requires testing," and "(3)" performing limited procedures with respect to certain other information appearing in the Accountability Report.

Delete the following:

" (8) tested compliance with selected provisions of the following laws and regulations [do not list any laws and regulations]."

Add the following words in quotation marks:

We performed our work in accordance with U.S. generally accepted government auditing standards and OMB audit guidance. "We considered the limitations on the scope of our work in forming our conclusions."

Note 5: Disclaimer of a report on the financial statements, internal control, or compliance with laws and regulations

If scope limitations on our work on the financial statements, internal control, or compliance with laws and regulations result in the omission of the statement that we found no inconsistency of other information, delete the following words in quotation marks from the objectives, scope, and methodology section:

We are also responsible for ... "and (3) performing limited procedures with respect to certain other information appearing in the Accountability Report."

Add the following words in quotation marks:

We performed our work in accordance with U.S. generally accepted government auditing standards and OMB audit guidance. "We considered the limitations on the scope of our work in forming our conclusions."

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## Reporting Phase

### 595 B - Suggested Modifications to Auditor's Report

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Note 6: Reporting both material weaknesses and other reportable conditions in the significant matters section

If both material weaknesses and other reportable conditions are included in the significant matters section, the opinion on internal control should include the changes for material weaknesses first, and then should continue with an additional paragraph for reportable conditions that begins "Our work also identified the need to improve certain internal controls...."

Note 7: Explanatory paragraphs

Explanatory paragraphs may be included in either the significant matters section or the opinion section of the report as discussed in paragraph 580.26.

Note 8: No management assertion about the effectiveness of internal control

In the objectives, scope, and methodology section, delete the following words in quotations marks:

We are responsible for obtaining reasonable assurance about whether "(1)" the financial statements are presented fairly, in all material respects, in conformity with generally accepted accounting principles "and (2) management maintained effective internal control, the objectives of which are the following:

- Financial reporting: Transactions are properly recorded, processed, and summarized to permit the preparation of financial statements and stewardship information in conformity with generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition.
- Compliance with laws and regulations: Transactions are executed in accordance with laws governing the use of budget authority and with other laws and regulations that could have a direct and material effect on the financial statements and any other laws, regulations, and governmentwide policies identified by OMB audit guidance." ... [continue with rest of paragraph]

Insert the following words in quotation marks into the sentence following the objectives:

We are also responsible for "obtaining a sufficient understanding of internal control over financial reporting and compliance to plan the audit and for" testing compliance with ...

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Add the following sentence at the end of the paragraph that begins, "We did not evaluate all internal controls..."

"In addition, we caution that our internal control testing may not be sufficient for other purposes."



## Reporting Phase

### 595 C - EXAMPLE SUMMARY OF POSSIBLE ADJUSTMENTS

Summary of Possible Adjustments (In Thousands)							
From W/P	Description	Known misstatements		Likely misstatements		Corrected by entity? <sup>a</sup>	W/P Ref <sup>b</sup>
		Debit	Credit	Debit	Credit		
XX	<i>Contractual Services Accounts Payable</i>  <i>Services received, not recorded.</i>	<i>\$ 2,000</i>	<i>\$ 2,000</i>	<i>\$ 4,000</i>	<i>\$ 4,000</i>	<i>Known - No Likely - No</i>	
XX	<i>Inventory Accounts Payable</i>  <i>Inventory received, not recorded.</i>	<i>4,000</i>	<i>4,000</i>	<i>7,000</i>	<i>7,000</i>	<i>Known - Yes Likely - No</i>	
	<b>Total</b>	<i>\$ 6,000</i>	<i>\$ 6,000</i>	<i>\$11,000</i>	<i>\$11,000</i>		

Note: Conclude (in consultation with the Reviewer as discussed in 540.04) as to the adequacy of the scope of procedures performed in light of the total likely misstatements above. (This is the document that is attached to the management representation letter, per SAS 89.)

<sup>a</sup> Post any uncorrected known or likely misstatements to the Summary of Unadjusted Misstatements for further consideration.

<sup>b</sup> Reference should be to the adjustments posted on the trial balance or to the Summary of Unadjusted Misstatements if the entity declines to record an adjustment to the principal statements.

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## Reporting Phase

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### **595 D - EXAMPLE SUMMARY OF UNADJUSTED MISSTATEMENTS**

- .01 The Summary of Unadjusted Misstatements, as discussed in paragraph 540.09, is used to accumulate known and likely misstatements that are identified by the auditor but not corrected by the entity in the principal statements. The source of these unadjusted misstatements is the Summary of Possible Adjustments (section 595 C).

**Reporting Phase**  
**595 D - Example Summary of Unadjusted Misstatements**

(Dollars in thousands)	Adjustment number	Known misstatements			Likely misstatements			Adjusted account balance workpaper reference	Adjusted account balance debit (Credit)	Likely misstatement as a percentage of account balance overstatement (Understatement)
		Debit	(Credit)	Net debit (credit)	Debit	(Credit)	Net debit (credit)			
Assets:										
Cash	1	\$ 100		\$ 100	\$ 100		\$ 100		[The auditor would reference the adjusted account balances to the appropriate working paper (for example, the final trial balance)].	\$ 12,000 (0.83)%
Investments								80,000		0.00%
Loans receivable	2		\$(1,400)	(1,400)		\$(1,400)	(1,400)	120,000		1.17%
Interest receivable	3	120		120	220		220	60,000		(0.37)%
<b>Total assets</b>		<b>\$ 220</b>	<b>\$(1,400)</b>	<b>\$(1,180)</b>	<b>\$ 320</b>	<b>\$(1,400)</b>	<b>\$(1,080)</b>	<b>\$ 272,000</b>		<b>0.40%</b>
Liabilities:										
Accounts payable	4		\$ (150)	\$(150)		\$ (350)	\$(350)	\$(175,000)		(0.20)%
Other liabilities	5		(40)	(90)		(100)	(300)	(85,000)		(0.35)%
	6		(50)			(200)				
<b>Total liabilities</b>		<b>\$ 0</b>	<b>(240)</b>	<b>(240)</b>	<b>\$ 0</b>	<b>(650)</b>	<b>(650)</b>	<b>(260,000)</b>		<b>(0.25)%</b>
Equity of U.S. government:										
Beginning of year								(2,000)		0.00%
Net current year (surplus) deficit		1,640	(220)	1,420	2,050	(320)	1,730	(10,000)		17.30%
<b>Total equity</b>		<b>1,640</b>	<b>(220)</b>	<b>1,420</b>	<b>2,050</b>	<b>(320)</b>	<b>1,730</b>	<b>(12,000)</b>		<b>14.42%</b>
<b>Total liabilities and equity</b>		<b>\$1,640</b>	<b>\$(460)</b>	<b>\$ 1,180</b>	<b>\$2,050</b>	<b>\$(970)</b>	<b>\$ 1,080</b>	<b>\$(272,000)</b>		<b>0.40%</b>

**Reporting Phase**  
**595 D - Example Summary of Unadjusted Misstatements**

(Dollars in thousands)	Adjustment number	<u>Known misstatements</u>			<u>Likely misstatements</u>			Adjusted account balance workpaper reference	Adjusted account balance debit (credit)	Likely misstatement as a percentage of account balance overstatement (Understatement)
		Debit	(Credit)	Net debit (credit)	Debit	(Credit)	Net debit (credit)			
Operating revenues	1 3		\$ (100) (120)	\$ (220)		\$ (100) (220)	\$ (320)	\$ 250,000	(0.13)%	
Other financing sources		<hr/>			<hr/>				<u>500,000</u>	<u>0.00%</u>
Total revenues and other financing sources		\$ 0	(220)	(220)	\$ 0	(320)	(320)	<u>750,000</u>	<u>(0.04)%</u>	
Operating expenses:										
Personnel	4	150		150	350		350	425,000	(0.08)%	
Supplies	5	40		40	100		100	115,000	(0.09)%	
Rent, communication, and utilities	6	50		50	200		200	125,000	(0.16)%	
Provision for losses	2	<u>1,400</u>		<u>1,400</u>	<u>1,400</u>		<u>1,400</u>	<u>75,000</u>	<u>(1.87)%</u>	
Total operating expenses		<u>1,640</u>	0	<u>1,640</u>	<u>2,050</u>	0	<u>2,050</u>	<u>740,000</u>	<u>(0.28)%</u>	
<b>Net results - (surplus) deficit</b>		<u><b>\$ 1,640</b></u>	<u><b>\$ (220)</b></u>	<u><b>\$ 1,420</b></u>	<u><b>\$ 2,050</b></u>	<u><b>\$ (320)</b></u>	<u><b>\$ 1,730</b></u>	<u><b>\$ (10,000)</b></u>	<u><b>17.30%</b></u>	
<p>Conclusion: The identified, unadjusted misstatements listed above do not appear to materially misstate the financial statements taken as a whole from a quantitative or qualitative viewpoint. Unadjusted misstatements relating to the materiality base (operating expenses) are only 0.28 percent of the base (\$2.05 million divided by \$740 million).</p>										

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