



Agenda Item 1D

EXPOSURE DRAFT

PROPOSED STATEMENT ON AUDITING STANDARDS

AMENDMENTS TO AU-C SECTIONS 725, 730, 930, 935, AND 940

(Amends Statement on Auditing Standards [SAS])

- *No. 117, Compliance Audits, as amended [AICPA, Professional Standards, AU-C sec. 935]*
- *No. 119, Supplementary Information in Relation to the Financial Statements as a Whole, as amended [AICPA, Professional Standards, AU-C sec. 725]*
- *No. 120, Required Supplementary Information, as amended [AICPA, Professional Standards, AU-C sec. 730]*
- *No. 122, Statements on Auditing Standards: Clarification and Recodification, as amended, section 930, Interim Financial Information [AICPA, Professional Standards, AU-C sec. 930]*
- *No. 130, An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements, as amended [AICPA, Professional Standards, AU-C sec. 940]*

December 10, 2019

Comments are requested by February 10, 2020

Prepared by the AICPA Auditing Standards Board for comment from persons interested in auditing and reporting issues.

Comments should be submitted in Word format and sent to CommentLetters@aicpa-cima.com.

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Explanatory Memorandum

Introduction

This memorandum provides background to the proposed Statement on Auditing Standards (SAS) *Amendments to AU-C Sections 725, 730, 930, 935, and 940*.¹ If issued as final, the proposed SAS will amend the following SASs:

- No. 117, *Compliance Audits*, as amended (AICPA, *Professional Standards*, AU-C sec. 935)
- No. 119, *Supplementary Information in Relation to the Financial Statements as a Whole*, as amended (AICPA, *Professional Standards*, AU-C sec. 725)
- No. 120, *Required Supplementary Information*, as amended (AICPA, *Professional Standards*, AU-C sec. 730)
- No. 122, *Statements on Auditing Standards: Clarification and Recodification*, as amended, section 930, *Interim Financial Information* (AICPA, *Professional Standards*, AU-C sec. 930)
- No. 130, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*, as amended (AICPA, *Professional Standards*, AU-C sec. 940)

Background

SAS No. 134, *Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements* (AICPA, *Professional Standards*, AU-C sec. 700, 701, 705, and 706), was issued by the AICPA Auditing Standards Board (ASB) in May 2019 and changed the form and content of the auditor's report issued as a result of the audit of financial statements. AU-C sections 930, 935, and 940 contain requirements for auditor's reports in the circumstances addressed by the specific AU-C section and, accordingly, amendments are proposed to conform those requirements to the requirements of SAS No. 134.

In July 2019, the ASB issued SAS No. 137, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports* (AICPA, *Professional Standards*, AU-C sec. 720). AU-C sections 725 and 730 include requirements for the auditor to report on the supplementary information or required supplementary information, as applicable. As supplementary information and required supplementary information are comparable to other information, amendments are proposed to AU-C sections 725 and 730 to change the references to an other-matter paragraph to refer instead to a separate section in the auditor's report, consistent with SAS No. 137.

At its October meeting, the ASB voted to ballot to issue as a final standard proposed SAS *Amendments to the Description of Materiality*. Proposed SAS *Amendments to the Description of*

¹ All AU-C sections can be found in AICPA *Professional Standards*.

Materiality amends the requirements of AU-C section 700, and those amended requirements are reflected in this proposed SAS.

In addition to proposed amendments reflecting the issuance of SAS No. 134 and SAS No. 137, certain AU-C sections have been revised to reflect practice issues that have arisen since the most recent revisions to these AU-C sections. In particular, AU-C section 935 has also been revised for recent developments in the compliance arena, such as the issuance of Uniform Guidance, changes in the OMB Compliance Supplement, and the most recently issued Yellow Book.

Effective Date

If issued as final, the proposed amendments to

- a. AU-C sections 725 and 730 will be effective for audits of financial statements for periods ending on or after December 15, 2020. Early implementation is not permitted.
- b. AU-C section 930 will be effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2020. Early implementation is not permitted.
- c. AU-C section 935 will be effective for compliance audits for fiscal periods ending on or after December 15, 2020. Early implementation is not permitted.
- d. AU-C section 940 will be effective for integrated audits for periods ending on or after December 15, 2020. Early implementation is not permitted.

Explanation of Proposed Changes

The following is a summary of the proposed changes to extant AU-C sections 725, 730, 930, 935, and 940 that the ASB believes would be the most significant.

Proposed Revisions to AU-C section 930 (pages 14–32)

The proposed changes to the reporting requirements in paragraph .31 of AU-C section 930 include revisions for conformity with SAS No. 134 and also to harmonize with the requirements in the PCAOB's Auditing Standard (AS) 4105, *Reviews of Interim Financial Information*. The proposed changes include the placement of the auditor's review conclusion at the beginning of the review report on interim financial information.

The proposed changes also require that the review report be dated no earlier than the date on which the auditor ***completed procedures sufficient to obtain limited assurance as a basis for reporting whether the auditor is aware of any material modifications that should be made to the interim financial information in order for it to be in accordance with the applicable financial reporting framework***. The proposed dating convention is consistent with the corresponding conventions in

AS 4105 and AR-C section 90, *Review of Financial Statements*.² However, the convention is not consistent with the corresponding requirement in AU-C section 700, which requires that the auditor's report be dated no earlier than the date on which the auditor *has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements*. The corresponding dating convention in AT-C section 210, *Review Engagements*,³ is consistent with the dating convention in AU-C section 700.

Request for Comment Specific to AU-C Section 930

1. Are the proposed amendments to AU-C section 930 appropriate and complete?
2. Should the reporting requirements in paragraph .31 include revisions for harmonization with the requirements in PCAOB AS 4105, including the placement of the auditor's review conclusion at the beginning of the review report on interim financial information?
3. Do you agree with aligning the dating requirement to be consistent with that of PCAOB AS 4105 and AR-C section 90?

Proposed Revisions to AU-C Section 935 (pages 33–56)

The proposed changes to AU-C section 935 include revisions for conformity with SAS No. 134 and to be consistent with current governmental requirements. In addition to the proposed changes to the reporting requirements in paragraph .30 of AU-C section 935 to conform with SAS No. 134, significant changes include the following:

- Updating the appendix, "AU-C Sections That Are Not Applicable to Compliance Audits," for the issuance of SAS Nos. 131–137, as applicable.
- Presenting requirements for a combined report on compliance and internal control as the default form of report, followed by requirements addressing when the auditor chooses to issue separate reports on compliance and on internal control over compliance. This reverses how the requirements are presented in extant AU-C section 935 because combined reports are more common in practice.
- Revising the definition of *material noncompliance* to align with the description of *materiality* in the *SAS Amendments to the Description of the Concept of Materiality*.
- Updating references to *OMB Circular A-133* to refer instead to *the Uniform Guidance* and addressing changes in the OMB Compliance Supplement and the most recently issued Yellow Book.

² All AR-C sections can be found in AICPA *Professional Standards*.

³ All AT-C sections can be found in AICPA *Professional Standards*.

Request for Comment Specific to AU-C Section 935

1. Are the proposed amendments to the appendix appropriate and complete, including the proposed amendments to be consistent with current government requirements? If not, please suggest specific revisions.
2. Do you agree with how the combined report and the separate reports are addressed in the standard? If not, please suggest specific revisions.

Proposed Revisions to AU-C Section 940 (pages 57–88)

The proposed amendments to AU-C section 940 include revisions to the form and content of the auditor’s report on internal control over financial reporting (ICFR) to conform with SAS No. 134. In addition to the proposed changes to the reporting requirements in paragraph .64 of AU-C section 940 to conform with SAS No. 134, significant changes include the following:

- Requiring the “Auditor’s Responsibilities for the Audit of ICFR” section to include a statement that internal control over financial reporting is not effective if a material weakness exists (paragraph .64)
- When issuing a separate report on ICFR, requiring a paragraph
 - to be placed within the “Opinion” section following the opinion paragraph in the auditor’s report on the financial statements that references to the report on ICFR (paragraph .65)
 - to be placed within the “Opinion on Internal Control Over Financial Reporting” section following the opinion paragraph in the report on ICFR that references to the report on the financial statements (paragraph .65)
- Revising requirements on how to report when issuing an adverse opinion or disclaiming an opinion because of a scope limitation (paragraphs .69–.71 and .75–.76)
- Addressing situations when management includes additional information in management’s report or includes additional information in a document containing management’s report and the related auditor’s report (paragraph .80)

Request for Comment Specific to AU-C Section 940

1. Are the proposed amendments to AU-C section 940 appropriate and complete?
2. Do you agree with the proposed
 - a. amendment to require a statement in the “Auditor’s Responsibilities for the Audit of ICFR” section that states internal control over financial reporting is not effective if a material weakness exists?
 - b. placement of the paragraphs when issuing a separate report on ICFR as required by the proposed amendments to paragraph .65?
 - c. placement of the paragraphs when issuing an adverse opinion on ICFR due to a

- material weakness as required by the proposed amendments to paragraph .69?
- d. amendments to paragraph .80 for reporting when additional information is included in management's report or in a report that includes management's report and the auditor's report?

AU-C Section 910

SAS No. 124, *Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country* (AICPA, *Professional Standards*, AU-C sec. 910), includes an exhibit, "Illustrations of Auditor's Reports on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country." This exhibit will be revised to be consistent with SAS No. 134. There are no proposed amendments to the requirements or application material of AU-C section 910. The revised illustrative auditor's reports have been included as an exhibit in this exposure draft for transparency.

Guide for Respondents

Respondents are asked to comment on the proposed changes to existing standards, including the illustrative reports, and whether they are consistent with SAS Nos. 134 and 137.

Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and, when appropriate, make specific suggestions for any proposed changes to wording. When a respondent agrees with proposals in the exposure draft, it will be helpful for the ASB to be made aware of this view, as well.

Written comments on the exposure draft will become part of the public record of the AICPA and will be available for public inspection at the offices of the AICPA for one year, beginning February 10, 2020. Responses should be submitted in Word format, sent to commentletters@aicpa-cima.com, and received by February 10, 2020. Respondents may also submit a PDF version of their response for posting to the AICPA website.

Comment Period

The comment period for this exposure draft ends February 10, 2020.

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(2019–2020)**

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PROPOSED STATEMENT ON AUDITING STANDARDS

AMENDMENTS TO AU-C SECTIONS 725, 730, 930, 935, AND 940

(*Boldface italics* denotes new language. Deleted text is shown in ~~strikethrough~~.)

Proposed Amendment to AU-C Section 725

AU-C Section 725, Supplementary Information in Relation to the Financial Statements as a Whole

[No proposed amendment to paragraphs .01–.08]

Reporting

.09 When the entity presents the supplementary information with the financial statements, the auditor should report on the supplementary information in either (a) ~~an other-matter paragraph in accordance with section 706, *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*~~ **a separate section in the auditor's report on the financial statements with the heading "Supplementary Information," or other appropriate heading**, or (b) in a separate report on the supplementary information.² ~~The other-matter paragraph~~ **supplementary information section in the auditor's report on the financial statements** or separate report should include the following elements:

...

² ~~Paragraph .08 of section 706, *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*~~

[Subsequent footnotes renumbered. No proposed amendment to paragraphs .10–.A16.]

.A17

Exhibit—Illustrative Reporting Examples When the Auditor Is Reporting on Supplementary Information in Relation to the Financial Statements as a Whole

Illustration 1—~~An Other-Matter Paragraph~~ ***Supplementary Information Section in the Auditor's Report on the Financial Statements*** When the Auditor Is Issuing an Unmodified

Opinion on the Financial Statements and an Unmodified Opinion on the Supplementary Information

Illustration 2—~~An Other Matter Paragraph~~ ***Supplementary Information Section in the Auditor's Report on the Financial Statements*** When the Auditor Is Issuing a Qualified Opinion on the Financial Statements and a Qualified Opinion on the Supplementary Information

Illustration 3—~~An Other Matter Paragraph~~ ***Supplementary Information Section in the Auditor's Report on the Financial Statements*** When the Auditor Is Disclaiming an Opinion on the Financial Statements

Illustration 4—~~An Other Matter Paragraph~~ ***Supplementary Information Section in the Auditor's Report on the Financial Statements*** When the Auditor Is Issuing an Adverse Opinion on the Financial Statements

...

Illustration 1—~~An Other Matter Paragraph~~ *Supplementary Information Section in the Auditor's Report on the Financial Statements* When the Auditor Is Issuing an Unmodified Opinion on the Financial Statements and an Unmodified Opinion on the Supplementary Information

...

Illustration 2—~~An Other Matter Paragraph~~ *Supplementary Information Section in the Auditor's Report on the Financial Statements* When the Auditor Is Issuing a Qualified Opinion on the Financial Statements and a Qualified Opinion on the Supplementary Information

...

Illustration 3—~~An Other Matter Paragraph~~ *Supplementary Information Section in the Auditor's Report on the Financial Statements* When the Auditor Is Disclaiming an Opinion on the Financial Statements

...

Illustration 4—~~An Other Matter Paragraph~~ *Supplementary Information Section in the Auditor's Report on the Financial Statements* When the Auditor Is Issuing an Adverse Opinion on the Financial Statements

...

[No proposed amendment to Illustrations 5–8. No further amendment to AU-C section 725.]

- 1.** This amendment is effective for audits of financial statements for periods ending on or after December 15, 2020. Early implementation is not permitted.

Proposed Amendment to AU-C Section 730

AU-C Section 730, *Required Supplementary Information*

[No proposed amendment to paragraphs .01–.06.]

Reporting

.07 The auditor should include ~~an other-matter paragraph~~ *a separate section* in the auditor's report on the financial statements ***with the heading “Required Supplementary Information,” or other appropriate heading*** to refer to the required supplementary information in accordance with ~~section 706, *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*~~.³ The ~~other-matter paragraph~~ ***required supplementary information section in the auditor's report on the financial statements*** should include language to explain the following circumstances, as applicable:

...

³ ~~Paragraph .08 of section 706, *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*.~~

.08 If the entity has presented all or some of the required supplementary information, the ~~other-matter paragraph~~ ***required supplementary information section in the auditor's report on the financial statements*** referred to in paragraph .07 should include the following elements: (Ref: par. .A2)

...

.09 If all of the required supplementary information is omitted, the ~~other-matter paragraph~~ ***required supplementary information section in the auditor's report on the financial statements*** should include the following elements:

...

[No proposed amendment to paragraphs .A1–.A2.]

.A3

Exhibit—Examples of ~~Other-Matter Paragraphs When Reporting on Required Supplementary Information~~ Sections in the Auditor's Report on the Financial Statements

....

[No further amendment to AU-C section 730.]

2. This amendment is effective for audits of financial statements for periods ending on or after December 15, 2020. Early implementation is not permitted.

Proposed Amendment to AU-C Section 930

AU-C Section 930, *Interim Financial Information*

[No proposed amendment to paragraphs .01–.30.]

.31 The written review report should include the following: (Ref: par. ~~.A42–.A43.A41–.A42~~)

- a. A title that includes the word *independent* to clearly indicate that it is the report of an independent auditor.
- b. An addressee as appropriate ~~for~~ ***based on*** the circumstances of the engagement. (Ref: par. ~~.A43~~)
- c. ~~An introductory paragraph that~~ ***The first section of the auditor’s report on a review of interim financial information should include the auditor’s conclusion and should have the heading “Results of Review of Interim Financial Information,” and the following elements:***
 - i. ~~identifies~~ ***The name of*** the entity whose interim financial information has been reviewed
 - ii. ~~states~~ ***A statement*** that the interim financial information identified in the report was reviewed
 - iii. ~~identifies the~~ ***The title of each statement that*** interim financial information ***comprises*** and (Ref: par. ~~.A44–.A45~~)
 - iv. ***A reference to the notes***
 - iv. ~~specifies the~~ ***The dates of*** or periods covered by each financial statement ***comprising that*** the interim financial information ***comprises***.
 - vi. ***A statement about whether the auditor is aware of any material modifications that should be made to the accompanying interim financial information for it to be in accordance with the applicable financial reporting framework and that identifies the country of origin of those accounting principles, if applicable*** (Ref: par. ~~.A46–.A49~~)
- d. ~~A section with the heading “Management’s Responsibility for the Financial Statements” that includes an explanation that management is responsible for the preparation and fair presentation of the interim financial information in accordance with the applicable financial reporting framework; this responsibility includes the design, implementation, and maintenance of internal control sufficient to provide a~~

~~reasonable basis for the preparation and fair presentation of interim financial information in accordance with the applicable financial reporting framework. A section, directly following the “Results of Interim Financial Information” section, that includes the heading “Basis for Review Results,” and includes the following statements: (Ref: par. . A50)~~

- ~~i. The review was conducted in accordance with auditing standards generally accepted in the United States of America applicable to reviews of interim financial information. (Ref: par. .A51)~~
 - ~~ii. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters.~~
 - ~~iii. A review of interim financial information is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is an expression of an opinion regarding the financial information as a whole, and accordingly, the auditor does not express such an opinion.~~
 - ~~iv. The auditor is required to be independent of the entity and to meet the auditor’s other ethical responsibilities, in accordance with the relevant ethical requirements relating to the review. (Ref: par. .A52–.A53)~~
 - ~~v. The auditor believes that the results of the review procedures provide a reasonable basis for the auditor’s conclusion.~~
- ~~e. A section that includes the heading “Management’s Responsibility for the Interim Financial Information” and includes a statement that management is responsible for the preparation and fair presentation of the interim financial information in accordance with the applicable financial reporting framework, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of interim financial information that is free from material misstatement, whether due to fraud or error.~~
- ~~e. A section with the heading "Auditor’s Responsibility" that includes the following statements:~~
- ~~i. The auditor’s responsibility is to conduct the review of interim financial information in accordance with auditing standards generally accepted in the United States of America applicable to reviews of interim financial information.~~
 - ~~ii. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters.~~

- ~~iii. A review of interim financial information is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is an expression of an opinion regarding the financial information as a whole, and accordingly, no such opinion is expressed.~~
- ~~f. A concluding section with an appropriate heading that includes a statement about whether the auditor is aware of any material modifications that should be made to the accompanying interim financial information for it to be in accordance with the applicable financial reporting framework and that identifies the country of origin of those accounting principles, if applicable.~~
- f. The manual or printed signature of the auditor's firm. (*Ref: par. .A54–.A56*)
- g. The city and state where the auditor's ~~practices~~ *report is issued*. (*Ref: par. .A57*)
- h. The date of the review report, which should be dated as ~~of the date of completion of the review procedures~~ *no earlier than the date on which the auditor completed procedures sufficient to obtain limited assurance as a basis for reporting whether the auditor is aware of any material modifications that should be made to the interim financial information in order for it to be in accordance with the applicable financial reporting framework, including evidence of the following (Ref: par. .A58):*
- i. All the statements and disclosures that the interim financial information comprises have been prepared.*
 - ii. Management has asserted that they have taken responsibility for the interim financial information.*

Going Concern

.32 When applicable, the auditor should report in accordance with AU-C section 570, The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern.

[Paragraphs .32–.37 are renumbered to paragraphs .33–.38. The content is unchanged.]

Separate Section in the Auditor's Review Report Regarding Going Concern

~~.38~~³⁹ The auditor should include an ~~emphasis-of-matter paragraph~~ *a separate section* in the auditor's review report *with the heading "Substantial Doubt About an Entity's Ability to Continue as a Going Concern,"* in any of the following circumstances, regardless of whether the entity is required under the applicable financial reporting framework to include a statement in the notes to the interim financial information that substantial doubt exists: (*Ref: par. .A51–.A52.A66–.A68*)

- a. ~~A going concern emphasis-of-matter paragraph~~ *Such a section* was included in the prior year's auditor's report and
 - i. the conditions or events ~~giving rise to the emphasis-of-matter paragraph that caused the auditor to conclude that substantial doubt about the entity's ability to continue as a going concern~~ continue to exist and
 - ii. those conditions or events *continue to* raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time and management's plans do not alleviate them.
- b. ~~A going concern emphasis-of-matter paragraph~~ *Such a section* was not included in the prior year's auditor's report and
 - i. management is required under the applicable financial reporting framework to include a statement in the notes to the interim financial information that substantial doubt exists and
 - ii. management has included such statement in the notes to the interim financial information.

[Paragraphs .39–.45 are renumbered to paragraphs .40–.46. The content is unchanged.]

Application and Other Explanatory Material

[No proposed amendment to paragraphs .A1–.A19.]

~~**A20**—The auditor may find the guidance in section 720A, *Other Information in Documents Containing Audited Financial Statements*, useful in considering other information included in documents containing interim financial information.~~

~~**A21**—The auditor may request component auditors involved in the engagement, if any, to read the other information.~~

[Paragraphs .A22–.A40 are renumbered to paragraphs .A20–.A38. The content is unchanged.]

The Auditor's Report on a Review of Interim Financial Information

Form of the Auditor's Review Report (Ref: par. .30–.31)

.A39 A written report encompasses reports issued in hard copy format and those using an electronic medium.

[Paragraphs .A41–.A43 are renumbered to paragraphs .A40–.A42. The content is unchanged.]

Addressee (Ref: par. .31b)

.A43 The auditor's report is normally addressed to those for whom the report is prepared. The report may be addressed to the entity whose interim financial information is being reviewed or to those charged with governance. A report on the interim financial information of an unincorporated entity may be addressed as circumstances dictate (for example, to the partners, general partner, or proprietor).

Results of Review of Interim Financial Information (Ref: par. .31c)

.A44 The identification of the title and the dates of, or periods covered by, each statement that the interim financial information comprises may also be achieved by referencing the table of contents in a document bound with or accompanying the interim financial information and auditor's report thereon.

.A45 When the auditor is aware that the reviewed interim financial information will be included in a document that contains information in addition to the interim financial information and the auditor's report thereon, the auditor may consider, if the form of presentation allows, identifying the page numbers on which the reviewed interim financial information is presented. This helps users identify the interim financial information to which the auditor's report relates.

.A46 As explained in AU-C section 200, the preparation and fair presentation of the financial statements by management and, when appropriate, those charged with governance requires the inclusion of an adequate description of the applicable financial reporting framework in the financial statements.⁹ That description is important because it advises users of the financial statements of the framework on which the financial statements are based.

⁹ Paragraphs .A2–.A3 of AU-C section 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Generally Accepted Auditing Standards.

.A47 The title of the financial statements identified in the “Results of Review of Interim Financial Information” section describes the information that is the subject of the auditor's conclusion.

.A48 The auditor's conclusion covers the interim financial information, as defined by the applicable financial reporting framework.

.A49 The identification of the applicable financial reporting framework in the auditor's conclusion is intended to advise users of the auditor's report of the context in which the auditor's conclusion is expressed. For example, the applicable financial reporting framework may be identified as accounting principles generally accepted in the United States of America or U.S. generally accepted accounting principles or International Financial Reporting Standards promulgated by the International Accounting Standards

Board (IASB) or International Financial Reporting Standard for Small- and Medium-Sized Entities promulgated by the IASB, as appropriate.

Basis for Review Results (Ref: par. .31d)

.A50 The “Basis for Review Results” section provides important context about the auditor’s conclusion. Accordingly, this section requires the “Basis for Review Results” section to directly follow the “Results of Review of Interim Financial Information” section in the auditor’s report.

.A51 The reference to the standards used conveys to the users of the auditor’s report that the review has been conducted in accordance with established standards. For example, the auditor’s report may refer to auditing standards generally accepted in the United States of America or U.S. generally accepted auditing standards applicable to reviews of interim financial information.

Relevant Ethical Requirements (Ref: par. .31d(v))

.A52 AU-C section 200 explains that ethical requirements consist of the AICPA Code of Professional Conduct together with rules of state boards of accountancy and applicable regulatory agencies that are more restrictive.¹⁰ When the AICPA Code of Professional Conduct applies, the auditor’s other ethical responsibilities relate to the principles of professional conduct (ET sec. 0.300, “Principles of Professional Conduct”).

¹⁰ Paragraph .A15 of AU-C section 200.

.A53 Relevant ethical requirements may exist in several different sources, such as ethical codes and additional rules and requirements within law and regulation. When independence and other relevant ethical requirements are contained in a limited number of sources, the auditor may choose to name the relevant sources (for example, the AICPA Code of Professional Conduct, when applicable; the rule or applicable regulation; or Government Auditing Standards promulgated by the Comptroller General of the United States) or may refer to a term that appropriately describes those sources. Relevant ethical requirements, including those pertaining to independence, in a group audit situation may be complex. AU-C section 600, Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors),¹¹ provides guidance for auditors in performing work on the financial information of a component for a group audit, including those situations in which the component auditor does not meet the independence requirements that are relevant to the group audit.

¹¹ Paragraphs .22–.23 of AU-C section 600, Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors).

Signature of the Auditor (Ref: par. .31g)

.A54 In some cases, law or regulation may allow for the use of electronic signatures in the auditor's report.

.A55 In certain situations, the auditor's report may be required by law or regulation to include the personal name and signature of the auditor, in addition to the auditor's firm.

.A56 This section would not preclude a governmental auditor from including the personal name and signature of the auditor in the auditor's report when, in certain situations, the governmental auditor is required by law or regulation or chooses to do so.

Auditor's Address (Ref: par. .31h)

.A57 In the United States, the location of the issuing office is the city and state. In another country, it may be the city and country.

Date of the Auditor's Report (Ref: par. .31i)

.A58 When an engagement quality control review is performed, AU-C section 220 requires that the auditor's report not be released prior to the completion of the engagement quality control review.¹²

¹² Paragraph .21 of AU-C section 220.

[Paragraphs .A44–.A50 are renumbered to paragraphs .A59–.A65. The content is unchanged.]

~~**Emphasis-of-Matter**~~ Separate Section *in the Auditor's Review Report* Regarding Going Concern (Ref: par. .3839)

~~**.A51A66**~~ See exhibit D, "Illustrations of ~~Emphasis-of-Matter Paragraphs~~ *the Separate Section* in the Auditor's Review Report *Regarding Going Concern*," for illustrative examples of ~~emphasis-of-matter paragraphs~~ *such separate section*.

~~**.A52A67**~~ If conditions or events have been identified during the interim review that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, but (a) no statement relating to substantial doubt is included in the notes to the interim financial information because management's plans have alleviated the substantial doubt or (b) the applicable financial reporting framework does not require inclusion of such statement in the notes to the interim financial information, the auditor may include ~~an emphasis-of-matter paragraph~~ *a separate section* when management has disclosed the conditions or events in the notes to the financial statements but a statement related to substantial doubt is not required to be included by the applicable financial reporting framework. The following is an illustration of ~~an emphasis-of-matter paragraph~~ *a separate section in the auditor's review report regarding going concern* when no statement relating to substantial doubt is included in the notes to the interim financial information but conditions or events are disclosed:

Substantial Doubt About the Entity's Ability to Continue as a Going Concern

As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency. Management's plans in regard to these matters are also described in Note X.

.A68 Paragraph .A47 of AU-C section 570 provides guidance when conditions or events have been identified during the interim review that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time and (a) management's plans have not alleviated the substantial doubt, and (b) the applicable financial reporting framework does not require inclusion of such statement in the notes to the interim financial information.

[Paragraphs .A53–.A60 are renumbered to paragraphs .A69–.A76. The content is unchanged.]

Exhibit B — Illustrations of Auditor's Review Reports on Interim Financial Information (Ref: par. .A43A42)

~~.A61A76~~

Illustration 1 — A Review Report on Interim Financial Information

Illustration 2 — A Review Report on Condensed Comparative Interim Financial Information

Illustration 3 — A Review Report That Refers to a Component Auditor's Review Report on the Interim Financial Information of a Significant Component of a Reporting Entity

Illustration 4 — A Review Report on Comparative Interim Financial Information When the Prior Period Was Reviewed by Another Auditor

Illustration 1 — A Review Report on Interim Financial Information

Circumstances include the following:

- A review of interim financial information presented as a complete set of financial statements, including disclosures

Independent Auditor's Review Report

[Appropriate Addressee]

Results of Review of Interim Financial Information

We have reviewed the accompanying [*describe the interim financial information or statements reviewed*] of ABC Company and its subsidiaries as of September 30, 20X1, and for the three-month and nine-month periods then ended, *and the related notes to the interim financial information.*

Based on our review, we are not aware of any material modifications that should be made to the accompanying interim financial information for it to be in accordance with [identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America].

Basis for Review Results

We conducted our review in accordance with auditing standards generally accepted in the United States of America (GAAS) applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. A review of interim financial information is substantially less in scope than an audit conducted in accordance with GAAS, the objective of which is an expression of an opinion regarding the financial information as a whole, and accordingly, we do not express such an opinion. We are required to be independent of ABC Company and to meet our other ethical responsibilities in accordance with the relative ethical requirements relating to our review. We believe that the results of the review procedures provide a reasonable basis for our conclusion.

Management's Responsibility for the Interim Financial Information

~~The Company's management~~ **Management** is responsible for the preparation and fair presentation of the interim financial information in accordance with [identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America]; ~~this responsibility includes~~ **and for** the design, implementation, and maintenance of internal control sufficient to provide a reasonable basis for **relevant to** the preparation and fair presentation of interim financial information in accordance with [identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America] **that is free from material misstatement, whether due to fraud or error.**

Auditor's Responsibility

~~Our responsibility is to conduct our review in accordance with auditing standards generally accepted in the United States of America applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial information. Accordingly, we do not express such an opinion.~~

Conclusion

~~Based on our review, we are not aware of any material modifications that should be made to the accompanying interim financial information for it to be in accordance with [identify~~

~~the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America].~~

~~[Auditor's signature]~~ **Signature of the auditor's firm]**

~~[Auditor's city]~~ **City and state where the auditor's report is issued]**

~~[Date of the auditor's report]~~

Illustration 2 — A Review Report on Condensed Comparative Interim Financial Information

The following is an example of a review report on a condensed balance sheet as of March 31, 20X1; the related condensed statements of income and cash flows for the three-month periods ended March 31, 20X1 and 20X0; and a condensed balance sheet derived from audited financial statements as of December 31, 20X0. If the auditor's report on the preceding year-end financial statements was other than unmodified or included an emphasis-of-matter paragraph *a separate section regarding* because of a going concern matter or *an emphasis-of-matter paragraph because of* an inconsistency in the application of accounting principles, the last paragraph of the illustrative report would be appropriately modified.

Independent Auditor's Review Report

[Appropriate Addressee]

Results of Review of Condensed Interim Financial Information

We have reviewed the condensed consolidated financial statements of ABC Company and subsidiaries, which comprise the condensed consolidated balance sheet as of March 31, 20X1, and the related condensed consolidated statements of income and cash flows for the three-month periods ended March 31, 20X1 and 20X0, *and the related notes to the condensed financial statements.*

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying condensed financial information for it to be in accordance with [identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America].

Basis for Review Results

We conducted our reviews in accordance with auditing standards generally accepted in the United States of America (GAAS) applicable to reviews of interim financial information. A review of condensed interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. A review of condensed interim financial information is substantially less in scope than an audit conducted in accordance with GAAS, the

objective of which is an expression of an opinion regarding the financial information as a whole, and accordingly, we do not express such an opinion. We are required to be independent of ABC Company and to meet our other ethical responsibilities in accordance with the relative ethical requirements relating to our review. We believe that the results of the review procedures provide a reasonable basis for our conclusion.

Management's Responsibility for the Interim Financial Information

~~The Company's management~~ **Management** is responsible for the preparation and fair presentation of the condensed interim financial information in accordance with [*identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America*]; ~~this responsibility includes~~ **and for** the design, implementation, and maintenance of internal control ~~sufficient to provide a reasonable basis for~~ **relevant to** the preparation and fair presentation of interim financial information in accordance with [*identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America*]**that is free from material misstatement, whether due to fraud or error.**

Auditor's Responsibility

~~Our responsibility is to conduct our reviews in accordance with auditing standards generally accepted in the United States of America applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial information. Accordingly, we do not express such an opinion.~~

Conclusion

~~Based on our reviews, we are not aware of any material modifications that should be made to the condensed financial information referred to above for it to be in accordance with [*identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America*].~~

Report on Condensed Balance Sheet as of [Date]

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheet as of December 31, 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the year then ended (not presented herein); and we expressed an unmodified audit opinion on those audited consolidated financial statements in our report dated February 15, 20X1. In our opinion, the accompanying condensed consolidated balance sheet of the Company and subsidiaries as of December 31, 20X0, is consistent, in all material respects, with the audited consolidated financial statements from which it has been derived.

~~[Auditor's signature]~~ **Signature of the auditor's firm**

~~[Auditor's city]~~ **City and state where the auditor's report is issued**

~~[Date of the auditor's report]~~

Illustration 3 — A Review Report That Refers to a Component Auditor's Review Report on the Interim Financial Information of a Significant Component of a Reporting Entity

Circumstances include the following:

- A review of interim financial information presented as a complete set of financial statements, including disclosures.
- The auditor is making reference to another auditor's review report on the interim financial information of a significant component of a reporting entity.

Independent Auditor's Review Report

[Appropriate Addressee]

Results of Review of Interim Financial Information

We have reviewed the accompanying [*describe the interim financial information or statements reviewed*] of ABC Company and subsidiaries as of September 30, 20X1, and for the three-month and nine-month periods then ended, **and the related notes to the interim financial information.**

Based on our review, and the review report of other auditors, we are not aware of any material modifications that should be made to the accompanying interim financial information for it to be in accordance with [identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America].

We were furnished with the report of other auditors on their review of the interim financial information of DEF subsidiary, whose total assets as of September 30, 20X1, and whose revenues for the three-month and nine-month periods then ended, constituted 15 percent, 20 percent, and 22 percent, respectively, of the related consolidated totals.

Basis for Review Results

We conducted our review in accordance with auditing standards generally accepted in the United States of America (GAAS) applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. A review of interim financial information is substantially less in scope than an audit conducted in accordance with GAAS, the objective of which is an expression of an opinion regarding the financial information as a whole, and

accordingly, we do not express such an opinion. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relative ethical requirements relating to our review. We believe that the results of the review procedures provide a reasonable basis for our conclusion.

Management's Responsibility for the Interim Financial Information

~~The Company's management~~ ***Management*** is responsible for the preparation and fair presentation of the interim financial information in accordance with [*identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America*]; ~~this responsibility includes and for~~ the design, implementation, and maintenance of internal control sufficient to ~~provide a reasonable basis for~~ ***relevant to*** the preparation and fair presentation of interim financial information in accordance with [*identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America*]***that is free from material misstatement, whether due to fraud or error.***

Auditor's Responsibility

~~Our responsibility is to conduct our review in accordance with auditing standards generally accepted in the United States of America applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial information. Accordingly, we do not express such an opinion.~~

~~We were furnished with the report of other auditors on their review of the interim financial information of DEF subsidiary, whose total assets as of September 30, 20X1, and whose revenues for the three month and nine month periods then ended, constituted 15 percent, 20 percent, and 22 percent, respectively, of the related consolidated totals.~~

Conclusion

~~Based on our review and the review report of other auditors, we are not aware of any material modifications that should be made to the accompanying interim financial information for it to be in accordance with [*identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America*].~~

~~[Auditor's signature]~~ **Signature of the auditor's firm**

~~[Auditor's city]~~ **City and state where the auditor's report is issued**

~~[Date of the auditor's report]~~

Illustration 4 — A Review Report on Comparative Interim Financial Information When the Prior Period Was Reviewed by Another Auditor

Circumstances include the following:

- A review of interim financial information presented as a complete set of financial statements, including disclosures as of March 31, 20X1, and for the three-month period then ended.
- Comparative information is presented for the balance sheet as of December 31, 20X0, and for the statements of income and cash flows for the comparable interim period.
- The December 31, 20X0, financial statements were audited, and the March 31, 20X0, interim financial information was reviewed, by another auditor.

Independent Auditor's Review Report

[Appropriate Addressee]

Results of Review of Interim Financial Information

We have reviewed the accompanying [*describe the interim financial information or statements reviewed*] of ABC Company and subsidiaries as of March 31, 20X1, and for the three-month period then ended, **and the related notes to the interim financial information.**

Based on our review we are not aware of any material modifications that should be made to the accompanying interim financial information as of and for the three months ended March 31, 20X1, for it to be in accordance with [identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America].

The consolidated statements of income and cash flows of ABC Company and its subsidiaries for the three-month period ended March 31, 20X0, were reviewed by other auditors whose report dated June 1, 20X0, stated that based on their review, they were not aware of any material modifications that should be made to those statements in order for them to be in accordance with [*identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America*]. The consolidated balance sheet of the Company as of December 31, 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the year then ended (not presented herein), were audited by other auditors whose report dated March 15, 20X1, expressed an unmodified opinion on those statements.

Basis for Review Results

We conducted our review in accordance with auditing standards generally accepted in the United States of America (GAAS) applicable to reviews of interim financial

information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. A review of interim financial information is substantially less in scope than an audit conducted in accordance with GAAS, the objective of which is an expression of an opinion regarding the financial information as a whole, and accordingly, we do not express such an opinion. We are required to be independent of ABC Company and to meet our other ethical responsibilities in accordance with the relative ethical requirements relating to our review. We believe that the results of the review procedures provide a reasonable basis for our conclusion.

Management's Responsibility for the Interim Financial Information

~~The Company's management~~ **Management** is responsible for the preparation and fair presentation of the interim financial information in accordance with [*identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America*]; ~~this responsibility includes~~ **and for** the design, implementation, and maintenance of internal control ~~sufficient to provide a reasonable basis for~~ **relevant to** the preparation and fair presentation of interim financial information ~~in accordance with [*identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America*]~~ **that is free from material misstatement, whether due to fraud or error.**

Auditor's Responsibility

~~Our responsibility is to conduct our review in accordance with auditing standards generally accepted in the United States of America applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial information. Accordingly, we do not express such an opinion.~~

Conclusion

~~Based on our review, we are not aware of any material modifications that should be made to the accompanying interim financial information as of and for the three months ended March 31, 20X1, for it to be in accordance with [*identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America*].~~

~~[Auditor's signature]~~ **Signature of the auditor's firm]**

~~[Auditor's city]~~ **City and state where the auditor's report is issued]**

~~[Date of the auditor's report]~~

Exhibit C — Illustrations of Example Modifications to the Auditor’s Review Report Due to Departures From the Applicable Financial Reporting Framework (Ref: par. .A49A64)

.A62A77

Illustration 1 — Modification Due to a Departure From the Applicable Financial Reporting Framework

Illustration 2 — Modification Due to Inadequate Disclosure

Illustration 1 — Modification Due to a Departure From the Applicable Financial Reporting Framework

The following is an example of a modification of the auditor’s review report due to a departure from the applicable financial reporting framework:

Based on our review, with the exception of the matters described in the Basis for Modified Conclusion section of our report, we are not aware of any material modifications that should be made to the accompanying interim financial information for it to be in accordance with [identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America].

[~~Basis for Modification~~ **Modified Conclusion Paragraph**]

Based on information furnished to us by management, we believe that the Company has excluded from property and debt in the accompanying balance sheet certain lease obligations that we believe should be capitalized to be in accordance with [*identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America*]. This information indicates that if these lease obligations were capitalized at September 30, 20X1, property would be increased by \$_____, long-term debt would be increased by \$_____, and net income would be increased (decreased) by \$_____ and \$_____, respectively, for the three-month and nine-month periods then ended.

[~~Conclusion~~]

~~Based on our review, with the exception of the matter(s) described in the preceding paragraph(s), we are not aware of any material modifications that should be made to the accompanying interim financial information for it to be in accordance with [identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America].~~

Illustration 2 — Modification Due to Inadequate Disclosure

The following is an example of a modification of the auditor's review report due to inadequate disclosure:

Based on our review, with the exception of the matters described in the Basis for Modified Conclusion section of our report, we are not aware of any material modifications that should be made to the accompanying interim financial information for it to be in accordance with [identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America].

[Basis for ~~Modification~~ Modified Conclusion Paragraph]

Management has informed us that the Company is presently defending a claim regarding *[describe the nature of the loss contingency]* and that the extent of the Company's liability, if any, and the effect on the accompanying interim financial information is not determinable at this time. The interim financial information fails to disclose these matters, which we believe are required to be disclosed in accordance with *[identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America].*

[Conclusion]

~~Based on our review, with the exception of the matter(s) described in the preceding paragraph(s), we are not aware of any material modifications that should be made to the accompanying interim financial information for it to be in accordance with [identify the applicable financial reporting framework; for example, accounting principles generally accepted in the United States of America].~~

Exhibit D — Illustrations of ~~Emphasis-of-Matter Paragraphs~~ *Separate Sections Regarding Going Concern in the Auditor's Review Report (Ref: par. .A51A66)*

~~.A63~~A78

Illustration 1 — ~~Emphasis-of-Matter Paragraph~~ *Separate Section* When Substantial Doubt is Disclosed in the Notes to the Financial Statements, a *Separate Section Regarding* Going Concern ~~Emphasis-of-Matter Paragraph~~ Was Included in the Prior Year's Audit Report, and Conditions or Events Giving Rise to the ~~Emphasis-of-Matter Paragraph~~ *Separate Section* Have Been Identified and Substantial Doubt Exists

Illustration 2 — ~~Emphasis of Matter Paragraph~~ *Separate Section* When Substantial Doubt is Not Disclosed in the Notes to the Financial Statements, a *Separate Section Regarding Going Concern* ~~Emphasis of Matter Paragraph~~ Was Included in the Prior Year's Audit Report, and Conditions or Events Giving Rise to the ~~Emphasis of Matter Paragraph~~ *Separate Section* Have Been Identified and Substantial Doubt Exists

Illustration 3 — ~~Emphasis of Matter Paragraph~~ *Separate Section* When Management is Required Under the Applicable Financial Reporting Framework to Include a Statement in the Notes to the Interim Financial Information that Conditions or Events Have Been Identified and Substantial Doubt Exists, Such Statement Is Included in the Notes to the Interim Financial Information, and a *Separate Section Regarding Going Concern* ~~Emphasis of Matter Paragraph~~ Was Not Included in the Prior Year's Audit Report

Illustration 1 — ~~Emphasis of Matter Paragraph~~ *Separate Section* When Substantial Doubt is Disclosed in the Notes to the Financial Statements, a *Separate Section Regarding Going Concern* ~~Emphasis of Matter Paragraph~~ Was Included in the Prior Year's Audit Report, and Conditions or Events Giving Rise to the ~~Emphasis of Matter Paragraph~~ *Separate Section* Have Been Identified and Substantial Doubt Exists

The following is an example of situations in which (a) a *separate section regarding* going concern ~~emphasis of matter paragraph~~ was included in the prior year's auditor's report, (b) conditions or events have been identified and substantial doubt continues to exist, and (c) the entity is required under the applicable financial reporting framework to include a statement in the notes to the interim financial information that substantial doubt exists.

~~[Emphasis of Matter Paragraph]~~ Substantial Doubt About the Entity's Ability to Continue as a Going Concern

The accompanying interim financial information has been prepared assuming that the Company will continue as a going concern. Note 4 of the Company's audited financial statements as of December 31, 20X1, and for the year then ended, includes a statement that substantial doubt exists about the Company's ability to continue as a going concern. Note 4 of the Company's audited financial statements also discloses the events and conditions, management's evaluation of the events and conditions, and management's plans regarding these matters, including the fact that the Company was unable to renew its line of credit or obtain alternative financing as of December 31, 20X1. Our auditor's report on those financial statements includes ~~an emphasis of matter paragraph~~ *a separate section* referring to the matters in Note 4 of those financial statements. As indicated in Note 3 of the accompanying interim financial information as of March 31, 20X2, and for the three months then ended, the Company was still unable to renew its line of credit or obtain alternative financing as of March 31, 20X2, and has stated that substantial doubt exists about the Company's ability to continue as a going concern. The accompanying interim financial information does not include any adjustments that might result from the outcome of this uncertainty.

Illustration 2 — ~~Emphasis-of-Matter Paragraph~~ *Separate Section* When Substantial Doubt is Not Disclosed in the Notes to the Financial Statements, a *Separate Section Regarding Going Concern* ~~Emphasis-of-Matter Paragraph~~ Was Included in the Prior Year’s Audit Report, and Conditions or Events Giving Rise to the ~~Emphasis-of-Matter Paragraph~~ *Separate Section* Have Been Identified and Substantial Doubt Exists

The following is an example of a situation in which (a) a *separate section regarding* going concern ~~emphasis-of-matter paragraph~~ was included in the prior year’s auditor’s report, (b) conditions or events have been identified and substantial doubt continues to exist, and (c) the entity is not required under the applicable financial reporting framework to include a statement in the notes to the interim financial information that substantial doubt exists.

~~[Emphasis-of-Matter Paragraph]~~ Substantial Doubt About the Entity’s Ability to Continue as a Going Concern

The accompanying interim financial information has been prepared assuming that the Company will continue as a going concern. Note 4 of the Company’s audited financial statements as of December 31, 20X1, and for the year then ended, discloses that the Company was unable to renew its line of credit or obtain alternative financing as of December 31, 20X1. Our auditor’s report on those financial statements includes an ~~emphasis-of-matter paragraph~~ a *separate section* referring to the matters in Note 4 of those financial statements, indicating that these matters raised substantial doubt about the Company’s ability to continue as a going concern. As indicated in Note 3 of the accompanying interim financial information as of March 31, 20X2, and for the three months then ended, the Company was still unable to renew its line of credit or obtain alternative financing as of March 31, 20X2. Management’s evaluation of the conditions and events and management’s plans regarding these matters are also disclosed in Note 3. The accompanying interim financial information does not include any adjustments that might result from the outcome of this uncertainty.

Illustration 3 — ~~Emphasis-of-Matter Paragraph~~ *Separate Section* When Management is Required Under the Applicable Financial Reporting Framework to Include a Statement in the Notes to the Interim Financial Information that Conditions or Events Have Been Identified and Substantial Doubt Exists, Such Statement is included in the Notes to the Interim Financial Information, and a *Separate Section Regarding Going Concern* ~~Emphasis-of-Matter Paragraph~~ Was Not Included in the Prior Year’s Audit Report

The following is an example of an ~~emphasis-of-matter paragraph~~ a *separate section* when (a) a *separate section regarding* going concern ~~emphasis-of-matter paragraph~~ was not included in the prior year’s auditor’s report, (b) the entity is required under the applicable financial reporting framework to include a statement in the notes to the interim financial information that conditions or events have been identified and substantial doubt exists, and (c) such statement is included in the notes to the interim financial information.

~~[Emphasis-of-Matter Paragraph]~~ Substantial Doubt About the Entity’s Ability to Continue as a Going Concern

The accompanying interim financial information has been prepared assuming that the Company will continue as a going concern. As discussed in Note 3 to the interim financial information, the Company has suffered recurring losses from operations, has a net capital deficiency, and has stated that substantial doubt exists about the Company's ability to continue as a going concern. Management's evaluation of the conditions and events and management's plans regarding these matters are also described in Note 3. The accompanying interim financial information does not include any adjustments that might result from the outcome of this uncertainty.

[No further amendment to AU-C section 930.]

3. This amendment is effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2020. Early implementation is not permitted.

Proposed Amendment to AU-C Section 935

AU-C Section 935, *Compliance Audits*

[No proposed amendments to paragraphs .01–.03.]

- .04** AU-C sections 200–~~800~~**900** address audits of financial statements, as well as other kinds of engagements. Generally, these AU-C sections can be adapted to the objectives of a compliance audit. However, those AU-C sections, or portions thereof, identified in the appendix cannot be adapted to a compliance audit because they address the matters that are not applicable to a compliance audit.

[No proposed amendments to paragraphs .05–.07.]

- .08** A compliance audit is based on the premise that management is responsible for the entity's compliance with compliance requirements. Management's responsibility for the entity's compliance with compliance requirements includes the following:
- a. Identifying the entity's government programs and understanding and complying with the compliance requirements
 - b. ~~Establishing~~ **Designing, implementing,** and maintaining effective controls that provide reasonable assurance that the entity administers government programs in compliance with the compliance requirements
 - c. Evaluating and monitoring the entity's compliance with the compliance requirements
 - d. Taking corrective action when instances of noncompliance are identified, including corrective action on audit findings of the compliance audit

[No proposed amendments to paragraph .09.]

- .10** The auditor's objectives in a compliance audit are to
- a. obtain sufficient appropriate audit evidence to form an opinion and report at the level specified in the governmental audit requirement ~~on~~ **about** whether the entity complied in all material respects with the applicable compliance requirements; and
 - b. identify audit and reporting requirements specified in the governmental audit requirement that are supplementary to GAAS and *Government Auditing Standards*, if any, and perform procedures to address those requirements.

Definitions

- .11 For purposes of adapting GAAS to a compliance audit, the following terms have the meanings attributed as follows:

Applicable compliance requirements. Compliance requirements that are subject to the compliance audit.

Audit findings. The matters that are required to be reported by the auditor in accordance with the governmental audit requirement.

Audit risk of noncompliance. The risk that the auditor expresses an inappropriate audit opinion on the entity's compliance when material noncompliance exists. Audit risk of noncompliance is a function of the risks of material noncompliance and detection risk of noncompliance.

Compliance audit. A program-specific audit or an organization-wide audit of an entity's compliance with applicable compliance requirements.

Compliance requirements. Laws, *statutes*, regulations, rules, and provisions of contracts or grant agreements applicable to *a* government ~~programs~~ *program* with which the entity is required to comply.

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

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

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

Government program. The means by which governmental entities achieve their objectives. For example, one of the objectives of the U.S. Department of Agriculture is to provide nutrition to individuals in need. Examples of government programs designed to achieve that objective are the Supplemental Nutrition

Assistance Program and the National School Lunch Program. Government programs that are relevant to this section are those in which a grantor or pass-through entity provides an award to another entity, usually in the form of a grant, contract, or other agreement. Not all government programs provide cash assistance; sometimes noncash assistance is provided (for example, a loan guarantee, commodities, or property).

Governmental audit requirement. A government requirement established by law, *statute*, regulation, rule, or provision of contracts or grant agreements requiring that an entity undergo an audit of its compliance with applicable compliance requirements related to one or more government programs that the entity administers. (Ref: par. .A4)

Grantor. A government agency from which funding for the government program originates.

Known questioned costs. Questioned costs specifically identified by the auditor. Known questioned costs are a subset of likely questioned costs.

Likely questioned costs. The auditor's best estimate of total questioned costs, not just the known questioned costs. Likely questioned costs are developed by extrapolating from audit evidence obtained, for example, by projecting known questioned costs identified in an audit sample to the entire population from which the sample was drawn.

Material noncompliance. In the absence of a definition of material noncompliance in the governmental audit requirement, ~~a failure to follow compliance requirements or a violation of prohibitions included in~~ ***noncompliance with the applicable compliance requirements that results in noncompliance is considered to be quantitatively or qualitatively material if there is a substantial likelihood that is quantitatively or qualitatively material, either individually or when aggregated with other noncompliance in the aggregate, it would influence the judgment made by a reasonable user the affected government program about compliance with the requirements of the government program as a whole based on the report on compliance.***

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

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

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

Organization-wide audit. An audit of an entity's financial statements and an audit of its compliance with the applicable compliance requirements as they relate to one or more government programs that the entity administers.

Pass-through entity. An entity that receives an award from a grantor or other entity and distributes all or part of it to another entity to administer a government program.

Program-specific audit. An audit of an entity's compliance with applicable compliance requirements as they relate to one government program that the entity administers. The compliance audit portion of a program-specific audit is performed in conjunction with either an audit of the entity's or the program's financial statements.

Questioned costs. Costs that are questioned by the auditor because (1) of a violation or possible violation of the applicable compliance requirements, (2) the costs are not supported by adequate documentation, or (3) the incurred costs appear unreasonable and do not reflect the actions that a prudent person would take in the circumstances.

Risk of material noncompliance. The risk that material noncompliance exists prior to the audit. This consists of two components, described as follows:

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

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

Significant deficiency in internal control over compliance. A deficiency, or a combination of deficiencies, in internal control over compliance that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Requirements

[No proposed amendments to paragraphs .12–.15.]

- .16** In performing risk assessment procedures, the auditor should inquire of management about whether there are findings and recommendations in reports or other written communications resulting from previous audits, attestation engagements, and internal or external monitoring that directly relate to the objectives of the compliance audit. The

auditor should gain an understanding of management's response to findings and recommendations that could have a material effect on the entity's compliance with the applicable compliance requirements (for example, taking corrective action). The auditor should use this information to **identify and** assess ~~risk~~ **risks of material noncompliance** and determine the nature, timing, and extent of the audit procedures for the compliance audit, including determining the extent to which testing the implementation of any corrective actions is applicable to the audit objectives.

Identifying and Assessing the Risks of Material Noncompliance (Ref: par. .A16–.A18)

- .17** The auditor should **identify and** assess the risks of material noncompliance whether due to fraud or error for each applicable compliance requirement and should consider whether any of those risks are pervasive to the entity's compliance because they may affect the entity's compliance with many compliance requirements.^{fn2}

^{fn2}— Paragraphs .28–.32 of section 315.

[Footnote 2 is deleted. Subsequent footnotes are renumbered.]

[No proposed amendments to paragraphs .18–.22.]

Written Representations

- .23** The auditor should request from management written representations that are tailored to the entity and the governmental audit requirement (Ref: par. .A28)
- a. acknowledging management's responsibility for understanding and complying with the compliance requirements;
 - b. acknowledging management's responsibility for ~~establishing~~ **designing, implementing,** and maintaining controls that provide reasonable assurance that the entity administers government programs in accordance with the compliance requirements;

[No further amendment to paragraph .23. No proposed amendments to paragraphs .24–.29.]

Reporting

Combined Report on Compliance ~~Only~~ and Internal Control Over Compliance

- .30** The auditor's **combined** report on compliance **and internal control over compliance** should be in writing and include the following ~~elements~~:
- a. **Title.** *The auditor's report should have a title that includes clearly indicates that it is the word report of an independent auditor.*
 - b. **Addressee.** *The auditor's report should be addressed, as An addressee appropriate, ~~for~~ based on the circumstances of the engagement.*

- c. *Report on Compliance. The report on compliance should be presented before the report on internal control over compliance and include the heading “Report on Compliance.”*
- ~~e. An introductory paragraph that includes the following:~~ d. **Opinion.** *The first section of the auditor’s report on compliance should include the auditor’s opinion and section with a heading that includes the word “Opinion” and indicates the level specified by the governmental audit requirement. The “Opinion” section of the auditor’s report should also do the following (Ref: par. A34):*
- i. *State that the entity’s compliance with the applicable compliance requirements has been audited*
 - ii. ~~Identification of~~ *Identify the applicable compliance requirements or include a reference to where they can be found*
 - iii. ~~Identification of~~ *Identify the one or more government programs covered by the compliance audit or reference to a separate schedule containing that information*
 - iii-iv. ~~Identification of~~ *Specify the period covered by the report*
 - v. *When expressing an unmodified opinion, state that, in the auditor’s opinion, the entity complied, in all material respects, with the applicable compliance requirements at the level specified by the governmental audit requirement*
- e. **Basis for Opinion.** *The auditor’s report on compliance should include a section, directly following the “Opinion” section, with the heading “Basis for Opinion,” that does the following:*
- i. *States that the audit of compliance was conducted in accordance with auditing standards generally accepted in the United States of America (GAAS), the standards applicable to financial audits contained in Government Auditing Standards (Government Auditing Standards) issued by the Comptroller General of the United States, and the governmental audit requirement*
 - ii. *Refers to the section of the auditor’s report that describes the auditor’s responsibilities under GAAS, Government Auditing Standards, and the governmental audit requirement*
 - iii. *Includes a statement that the auditor is required to be independent of the entity and to meet the auditor’s other ethical responsibilities in accordance with the relevant ethical requirements relating to the audit*

fn5

- iv. ~~A statement that~~ ***States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion***
- v. ~~A statement~~ ***States that the compliance audit does not provide a legal determination of the entity's compliance***

^{fn 4} See paragraphs .A38-.A39 of section 700, Forming an Opinion and Reporting on Financial Statements.

~~d.f. A~~ ***Management's Responsibilities. The auditor's report on compliance should include a section with the heading "Management's Responsibilities" that includes a statement that compliance with the applicable compliance requirements is the responsibility of the entity's management. Responsibilities of Management for Compliance." This section of the auditor's report should describe management's responsibility for compliance with the applicable compliance requirements and for the design, implement, and maintain designing, implementing, and maintaining effective internal control over compliance with the requirements of laws, statutes, regulations, rules, and provisions of contracts or grant agreements applicable to government programs.*** If the document containing the auditor's report contains a separate statement by management about its responsibility for the applicable compliance requirements, the auditor's report should not include a reference to such statement by management.

~~eg. Auditor's Responsibilities. The auditor's report on compliance should include a~~ ***A-section with the heading "Auditor's Responsibility-Responsibilities for the Audit of Compliance." This section of the auditor's report should do that includes the following statements:***

- i. ~~A statement~~ ***State that the auditor's responsibility is objectives of the auditor are to***
 - (1) ***obtain reasonable assurance about whether material noncompliance with the applicable compliance requirements occurred, whether due to fraud or error***
 - (2) ***express an opinion on the entity's compliance with the applicable compliance requirements based on the compliance audit***
- ii. ~~A statement~~ ***State that the compliance-reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit was conducted in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in GAAS, Government Auditing Standards, and the governmental audit requirement will always detect material noncompliance when it exists***

- iii. *State that the risk of not detecting material noncompliance resulting from fraud is higher than for that resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control*
- iv. *State that noncompliance with the applicable compliance requirements is to be considered quantitatively or qualitatively material to compliance if there is a substantial likelihood that, individually or in the aggregate, it would influence the judgment made by a reasonable user about compliance with the requirements of the government program as a whole based on the report on compliance*
- v. *Describe an audit by stating that, in performing an audit in accordance with GAAS, Government Auditing Standards, and the [insert the name of the governmental audit requirement or program-specific audit guide] the auditor's responsibilities are to*
 - (1) *exercise professional judgment and maintain professional skepticism throughout the audit.*
 - (2) *identify and assess the risks of material noncompliance whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include ~~A statement that the compliance audit included examining, on a test basis, evidence about~~ regarding the entity's compliance with ~~these~~ applicable compliance requirements and performing such other procedures as the auditor considered necessary in the circumstances.*
 - (3) *obtain an understanding of the applicable compliance requirements and the entity's internal control over compliance relevant to the audit in order to design audit procedures that are appropriate in the circumstances and to test and report on internal control over compliance in accordance with [the governmental audit requirement], but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over compliance. Accordingly, no such opinion is expressed.*
- ~~iv. A statement that the auditor believes the compliance audit provides a reasonable basis for the auditor's opinion~~
- ~~v. A statement that the compliance audit does not provide a legal determination of the entity's compliance~~
- vi. *State that the auditor is required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and any significant deficiencies and material weaknesses in internal control over compliance that the auditor identified during the audit*

~~f. If noncompliance results in a modified opinion, a section with an appropriate heading, indicating the basis for the modified opinion that includes a description of such noncompliance, or a reference to a description of such noncompliance in an accompanying schedule.^{fn-5} (Ref: .par A34)~~

~~^{fn-5} Paragraph .17 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.~~

h. If noncompliance that ***does not result in a modified opinion but*** is required to be reported by the governmental audit requirement is identified (that is, noncompliance that does not result in a modified opinion), ***the auditor's report should include*** an other-matter paragraph, ***in a separate section with the heading "Other Matter" or another appropriate heading***, that ^{fn-64} includes a description of such noncompliance or a reference to a description of such noncompliance in an accompanying schedule. (Ref: par. .A34)

^{fn-5} Paragraph .08 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

i. ***Report on Internal Control Over Compliance. The auditor's combined report on compliance and internal control over compliance should include a section with the heading "Report on Internal Control Over Compliance" that does the following:***

- i. Includes the definitions of deficiency in internal control over compliance, material weakness in internal control over compliance, and significant deficiency in internal control over compliance.***
- ii. States that the auditor's consideration of the entity's internal control over compliance was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies in internal control over compliance and therefore material weaknesses or significant deficiencies may exist that were not identified.***
- iii. States that the audit was not designed for the purpose of expressing an opinion on the effectiveness of the entity's internal control over compliance. Accordingly, no such opinion is expressed.***
- iv. Describes any identified material weaknesses and significant deficiencies in internal control over compliance or a reference to an accompanying schedule containing such a description.***
- v. If no material weaknesses in internal control over compliance were identified, includes a statement to that effect.***

ij. If the criteria used to evaluate compliance are

- i. established or determined by contractual agreement or regulatory provisions that are developed solely for the parties to the agreement or regulatory agency responsible for the provisions or
- ii. available only to the specified parties

an alert describing the purpose of the auditor's report ***on compliance and internal control over compliance*** and that the report is not suitable for any other purpose, as required by section 905, *Alert That Restricts the Use of the Auditor's Written Communication*.^{fn 76}

^{fn 6} See paragraphs .06a–b, .11, and .A11 of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*.

- ~~jk.~~ The manual or printed signature of the auditor's firm.
- ~~kl.~~ The city and state where the ~~auditor practices~~ ***auditor's report is issued***.
- ~~lm.~~ The date of the auditor's report. ***The auditor's report should be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on compliance, including evidence that management has asserted that it has identified the entity's government programs and has taken responsibility for understanding and complying with the applicable compliance requirements.*** (Ref: par. .A35)

~~Combined Report~~ ***Separate Reports on Compliance and Internal Control Over Compliance***

.31 If the auditor issues separate reports on compliance and internal control over compliance, the separate report on compliance would omit the elements related to internal control over compliance (paragraph .30i). The separate report on internal control over compliance would omit the elements related to compliance (paragraph .30c–h) and would include the following additional statements:

- a. ***A statement that the auditor audited the entity's compliance with applicable compliance requirements pertaining to [identify the government program or programs and the period audited] and a reference to the auditor's report on compliance***
- b. ***A statement that the compliance audit was conducted in accordance with auditing standards generally accepted in the United States of America (GAAS), the standards applicable to financial audits contained in Government Auditing Standards (Government Auditing Standards) issued by the Comptroller General of the United States, and the governmental audit requirement***
- c. ***A statement that management is responsible for designing, implementing, and maintaining effective internal control over compliance with the requirements of laws, statutes, regulations, rules, and provisions of contracts or grant agreements applicable to government programs***

- d. A statement that in planning and performing the compliance audit, the auditor considered the entity's internal control over compliance with the applicable compliance requirements to determine the auditing procedures for the purpose of expressing an opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance*
- e. A statement that the auditor is not expressing an opinion on internal control over compliance*

~~If the governmental audit requirement requires the auditor to report on internal control over compliance and the auditor combines the auditor's report on compliance with a report on internal control over compliance, the following should be added to the report elements listed in paragraph .30 in a section with the heading "Internal Control Over Compliance" that appears before the section required by paragraph 30i, if any:~~

- ~~*a. A statement that management is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, rules, and provisions of contracts or grant agreements applicable to government programs.*~~
- ~~*b. A statement that in planning and performing the compliance audit, the auditor considered the entity's internal control over compliance with the applicable compliance requirements to determine the auditing procedures for the purpose of expressing an opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance.*~~
- ~~*c. A statement that the auditor is not expressing an opinion on internal control over compliance.*~~
- ~~*d. A statement that the auditor's consideration of the entity's internal control over compliance was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses in internal control over compliance.*~~
- ~~*e. The definition of *deficiency in internal control over compliance* and *material weakness in internal control over compliance*.*~~
- ~~*f. A description of any identified material weaknesses in internal control over compliance or a reference to an accompanying schedule containing such a description.*~~
- ~~*g. If significant deficiencies in internal control over compliance were identified, the definition of *significant deficiency in internal control over compliance* and a description of the deficiencies or a reference to an accompanying schedule containing such a description.*~~

~~h. If no material weaknesses in internal control over compliance were identified, a statement to that effect.~~

~~i. The alert described in paragraph .30i. The alert should be included in all combined reports on the entity's compliance and internal control over compliance.~~

A combined report on compliance and internal control over compliance is presented in the exhibit "Illustrative Combined Report on Compliance ~~With Applicable Requirements~~ and Internal Control Over Compliance — (Unmodified Opinion on Compliance; No Material Weaknesses or Significant Deficiencies in Internal Control Over Compliance Identified)."

~~*Separate Report on Internal Control Over Compliance*~~

~~.32 If the governmental audit requirement requires the auditor to report on internal control over compliance and the auditor chooses to issue a separate report on internal control over compliance, the auditor should include in that separate report the elements in paragraph .31a i and the following additional elements:~~

~~a. a. A title that includes the word independent~~

~~b. A statement that the auditor audited the entity's compliance with applicable compliance requirements pertaining to [identify the government program(s) and the period audited] and a reference to the auditor's report on compliance~~

~~c. A statement that the compliance audit was conducted in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, and the governmental audit requirement~~

~~d. The manual or printed signature of the auditor's firm~~

~~e. The date of the auditor's report~~

[Extant paragraph .33 is renumbered as paragraph .32. The content is unchanged.]

Other Reporting Considerations

.3433 The auditor should modify the auditor's opinion on compliance in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*, if any of the following conditions exist:

a. ~~The compliance auditor concludes that, based on the audit identifies evidence obtained, material noncompliance with the applicable compliance requirements exists.~~

b. The auditor is unable to obtain sufficient appropriate audit evidence to conclude whether material noncompliance with the applicable compliance requirements that the auditor believes has a material effect on the entity's compliance exists.

b. A restriction on the scope of the compliance audit.

.34 *When noncompliance results in a modified opinion, the “Basis for Opinion” section, with an appropriately modified heading, should include a description of such noncompliance, or a reference to a description of such noncompliance in an accompanying schedule, and a statement that compliance with such requirements is necessary, in the auditor’s opinion, for the entity to comply with the applicable compliance requirements.*^{fn 7}

^{fn 7} *Paragraph .21 of section 705, Modifications to the Opinion in the Independent Auditor’s Report.*

[No proposed amendment to paragraph .35.]

~~**.36** In the absence of a governmental audit requirement to report on internal control over compliance, the auditor should, nevertheless, communicate in writing to management and those charged with governance identified significant deficiencies and material weakness in internal control over compliance.~~^{fn 8} (Ref: par. .A35–.A36)

.3736 The auditor also should communicate to those charged with governance of the auditor’s responsibilities under GAAS, *Government Auditing Standards*, and the governmental audit requirement, an overview of the planned scope and timing of the compliance audit, and *any significant deficiencies and material weaknesses in internal control over compliance that the auditor identified during the audit* ~~significant findings from the compliance audit~~^{fn 8, fn 9} (Ref: par. .A357–.A368)

^{fn 8} See section 265, *Communicating Internal Control Related Matters Identified in an Audit*.

^{fn 9} See section 260, *The Auditor’s Communication With Those Charged With Governance*.

[No proposed amendments to paragraphs .38–.43, renumbered as paragraphs .37–.42.]

Application and Other Explanatory Material

Introduction and Applicability

.A1 An example of an engagement to which this section is applicable is an audit performed in accordance with the provisions of ~~Office Title 2 U.S. Code of Management Federal Regulations (CFR) Part 200, Uniform Administrative Requirements, Cost Principles, and Budget (OMB) Circular A-133, Audits of States, Local Governments and Non-Profit Organizations Audit Requirements for Federal Awards (the Uniform Guidance)~~. This section is applicable because ~~OMB Circular A-133 the Uniform~~

Guidance is a governmental audit requirement that requires the auditor to perform a compliance audit in accordance with both GAAS and *Government Auditing Standards* and to express an opinion on compliance. Another example is a department specific requirement such as the U.S. Department of Housing and Urban Development *Audit Requirements Related to Entities Such As Public Housing Agencies, Nonprofit and For-Profit Housing Projects, and Certain Lenders*. An example of an engagement to which this section is not applicable is an engagement performed to satisfy a law or regulation requiring the entity to have an auditor determine whether the entity has spent transportation excise tax monies in accordance with the specific purposes outlined in the law or regulation, but not requiring that the audit be performed in accordance with both GAAS and *Government Auditing Standards*. Such an engagement could be performed under AT-C section 315; AT-C section 205; or AT-C section 215, *Agreed-Upon Procedures Engagements*, depending on the requirements of the government.

Law or regulation will not always indicate which standards to follow. In such cases, professional judgment will be needed to determine, based on the circumstances, the appropriate standards to follow. (Ref: par. .01)

- .A2** An example of a governmental audit requirement that calls for an examination of an entity's compliance with specified requirements in accordance with AT-C section 315 is the ***compliance attestation engagement of third-party servicers included in the U.S. Department of Education's audit guide Guide for Audits of Federal Student Financial Assistance Programs at Participating Institutions Proprietary Schools and Institution For Compliance Attestation Engagements of Third-Party Servicers Administering Title IV Programs***. (Ref: par. .01 and .03)

[No proposed amendments to paragraphs .A3–.A6.]

- .A7** Generally, for all of the purposes identified in paragraph .A6, the auditor's consideration of materiality is in relation to the government program ~~taken~~ as a whole. However, the governmental audit requirement may specify a different level of materiality for one or more of these purposes. For example, ~~for purposes of reporting findings of noncompliance, OMB Circular A-133~~ ***the Uniform Guidance requires states that the auditor's determination of whether noncompliance that is material for the purpose of reporting an audit finding is in relation to a type one of the 14 types of compliance requirements identified in the OMB Compliance Supplement (Compliance Supplement)***. (See paragraph .A10 for further information about the *Compliance Supplement*.)

[No proposed amendments to paragraph .A8.]

- .A9** Some governmental audit requirements specifically identify the applicable compliance requirements. Other governmental audit requirements provide a framework for the auditor to determine the applicable compliance requirements. For example, the *Compliance Supplement* provides such a framework for ~~OMB Circular A-133~~ ***compliance audits under the Uniform Guidance***.

- .A10** The following are some of the sources an auditor may consult when identifying and obtaining an understanding of the applicable compliance requirements:
- a. The *Compliance Supplement*, which is issued by OMB, and used in ~~OMB Circular A-133~~ **compliance** audits *under the Uniform Guidance*, contains the compliance requirements that typically are applicable to federal government programs, as well as suggested audit procedures when compliance requirements are applicable and have a direct and material effect on the entity's compliance. Part 7 of the *Compliance Supplement* provides guidance for identifying compliance requirements for programs not included therein.
 - b. The applicable program-specific audit guide issued by the grantor agency, which contains the compliance requirements pertaining to the government program and suggested audit procedures to test for compliance with the applicable compliance requirements.
- .A11** The following are procedures the auditor may perform to identify and obtain an understanding of the applicable compliance requirements if the *Compliance Supplement* or a program-specific audit guide is not applicable:
- a. Reading laws, **statutes**, regulations, rules, and provisions of contracts or grant agreements that pertain to the government program
 - b. Making inquiries of management and other knowledgeable entity personnel (for example, the chief financial officer, internal auditors, legal counsel, compliance officers, or grant or contract administrators)
 - c. Making inquiries of appropriate individuals outside the entity, such as
 - i. the office of the federal, state, or local program official or auditor, or other appropriate audit oversight organizations or regulators, about the laws and regulations applicable to entities within their jurisdiction, including statutes and uniform reporting requirements
 - ii. a third-party specialist, such as an attorney
 - d. Reading the minutes of meetings of the governing board of the entity being audited
 - e. Reading audit documentation about the applicable compliance requirements prepared during prior years' audits or other engagements
 - f. Discussing the applicable compliance requirements with auditors who performed prior years' audits or other engagements

The procedures listed in this paragraph also may assist the auditor in obtaining a further understanding of the applicable compliance requirements even when the *Compliance Supplement* or program-specific audit guide is applicable.

[No proposed amendments to paragraphs .A12–.A15.]

Identifying and Assessing the Risks of Material Noncompliance (Ref: par. .17)

.A16 Factors the auditor may consider in ***identifying and*** assessing the risks of material noncompliance are as follows:

- The complexity of the applicable compliance requirements
- The susceptibility of the applicable compliance requirements to noncompliance
- The length of time the entity has been subject to the applicable compliance requirements
- The auditor’s observations about how the entity has complied with the applicable compliance requirements in prior years
- The potential effect on the entity of noncompliance with the applicable compliance requirements
- The degree of judgment involved in adhering to the compliance requirements
- The auditor’s assessment of the risks of material misstatement in the financial statement audit

.A17 In ***identifying and*** assessing the risks of material noncompliance, the auditor may evaluate inherent risk of noncompliance and control risk of noncompliance individually or in combination.

[No proposed amendments to paragraphs .A18–.A20.]

.A21 An auditor may decide to use audit sampling to obtain sufficient appropriate audit evidence in a compliance audit. Section 530, *Audit Sampling*, discusses the factors to be considered in planning, designing, and evaluating audit samples, including sampling for tests of controls. In addition, the AICPA Audit Guide Government Auditing Standards and ~~*Circular A-133*~~ **Single Audits** contains guidance on sampling in the context of a compliance audit. (Ref: par. .19)

[No proposed amendments to paragraphs .A22–.A23.]

- .A24** Section 330 provides guidance related to designing and performing further audit procedures in response to the assessed risks of material noncompliance.^{fn15} *However, the paragraphs of sSection 330 that, which also addresses address* the use of audit evidence about the operating effectiveness of controls obtained in prior audits; are not applicable to a compliance audit.^{fn 16} (Ref: par. .20)

[Footnotes 15 and 16 are not shown for purposes of this proposed SAS.]

- .A25** Some governmental audit requirements, for example, in ~~OMB Circular A-133~~ *the Uniform Guidance*, require tests of the operating effectiveness of controls identified as likely to be effective, even if the auditor believes that such testing would be inefficient. (Ref: par. .20)

Supplementary Audit Requirements

- .A26** Examples of supplementary audit requirements are the requirements in ~~OMB Circular A-133~~ *the Uniform Guidance* for the auditor to
- perform specified procedures to identify major programs.
 - follow up on prior audit findings and perform procedures to assess the reasonableness of the summary schedule of prior audit findings. (Ref: par. .21)

[No proposed amendments to paragraphs .A27–.[A33].]

Reporting

- .A34** *An appropriate heading for the “Opinion” section indicates the level specified by the governmental audit requirement. For example, an appropriate heading for reports on compliance audits under the Uniform Guidance would be “Opinion on Each Major Federal Program.” (Ref: par. .30d)*
- .A35** *AU-C section 220, Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards, requires that, on or before the date of the auditor’s report, the engagement partner, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor’s report to be issued.*^{fn 18} *When an engagement quality control review is performed, AU-C section 220 requires that the auditor’s report not be released prior to the completion of the engagement quality control review.*^{fn19} (Ref: par. .30m)

^{fn18} See paragraph .19 of AU-C section 220, Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards, for further discussion.

^{fn19} *Paragraph .21 of AU-C section 220.*

[Extant paragraph .A33 is renumbered as paragraph A36. The content is unchanged.]

~~.A35~~**A37** When the auditor communicates ~~significant deficiencies or material weaknesses in internal control over compliance~~ **findings** to management and those charged with governance, *Government Auditing Standards* also requires the auditor to obtain **and report views of** ~~response from the responsible officials, preferably in writing,~~ concerning ~~their views on the findings, conclusions, and recommendations included in the auditor's report~~ **as well as any planned corrective actions** ~~on internal control over compliance and include a copy of any written response in the auditor's report.~~^{fn 1820} (Ref: par. .36)

^{fn 1820} See the "Reporting Views of ~~Responsibilities~~ **Responsible** Officials" section of *Government Auditing Standards*.

~~.A36~~**38**If such a written response is included in a document containing the auditor's written communication to management and those charged with governance concerning identified ~~significant deficiencies or material weaknesses in internal control over compliance~~ **views of responsible officials are included in the auditor's report or in an auditor-prepared document required by a governmental audit requirement that is incorporated by reference in the auditor's report**, the auditor may add a paragraph to the auditor's written communication disclaiming an opinion on such information. Following is an example of such a paragraph: (Ref: par. ~~.34~~**36**)

Example Entity's ~~ABC Agency's~~ written response to the ~~significant deficiencies [and material weaknesses]~~ **insert type of findings such as noncompliance or in** internal control over compliance] identified in our compliance audit **is described in the accompanying [insert name of document]. Example Entity's response** was not subjected to the auditing procedures applied in the ~~compliance~~ audit of ~~ABC Agency's~~ compliance and, accordingly, we express no opinion on ~~it~~ **the response.**

[No proposed amendments to paragraphs .A37-.A39, renumbered as paragraphs .A39-.A41.]

~~.A40~~**42**An example of an auditor-prepared document required by a governmental audit requirement that is incorporated by reference in the auditor's report is the schedule of findings and questioned costs in a compliance audit under ~~OMB Circular A-133~~ **the Uniform Guidance.**

Appendix — AU-C Sections That Are Not Applicable to Compliance Audits

~~.A41~~**43**The following AU-C sections and individually enumerated requirement paragraphs of specific AU-C sections are not applicable to a compliance audit performed under this section either because (a) they are not relevant to a compliance audit environment, (b) the procedures and guidance would not contribute to meeting the objectives of a compliance audit, or (c) the subject matter is specifically covered in this section. Where the table in this appendix specifies individual requirement paragraphs, rather than an entire AU-C

section, the application and other explanatory material paragraphs related to such requirement paragraphs also do not apply. However, an auditor may apply these AU-C sections and paragraphs if the auditor believes doing so will provide appropriate audit evidence in the specific circumstances to support the auditor’s opinion on compliance.

<i>AU-C Section</i>	<i>Paragraphs Not Applicable to Compliance Audits</i>
210, <i>Terms of Engagement</i>	Paragraphs .06a and .08a
240, <i>Consideration of Fraud in a Financial Statement Audit</i>	Paragraphs .26 and .32b
250, <i>Consideration of Laws and Regulations in an Audit of Financial Statements</i>	All
315, <i>Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement</i>	Paragraphs .12c, .26– .27 30 , and .33c
330, <i>Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained</i>	Paragraphs .13–.14, .19–.21, .26, and .31–.32
501, <i>Audit Evidence — Specific Considerations for Selected Items</i>	All
505, <i>External Confirmations</i>	All
510, <i>Opening Balances — Initial Audit Engagements, Including Reaudit Engagements</i>	Paragraphs .06, .08–.13, and .15–.17
540, <i>Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures</i>	All
550, <i>Related Parties</i>	All
560, <i>Subsequent Events and Subsequently Discovered Facts</i>	Paragraphs .09–.11 and .19–.20
570, <i>The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern</i>	All
600, <i>Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)</i>	Paragraphs .25a, .38, .40c, .54, and .55c .26, .39, .41c, .55, and .56c.
700, <i>Forming an Opinion and Reporting on Financial Statements</i>	Paragraphs .14–.18, .22–.42, and .44–.59 .13–.17, .21–.41, and .45–.60
701, Communicating Key Audit Matters in the Independent Auditor’s Report	All
703, Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA	All
705, <i>Modifications to the Opinion in the Independent Auditor’s Report</i>	Paragraphs .18–.20

Exposure Draft of proposed amendments to AU-C sections 725 730 930 935 and 940
ASB Meeting, March 11, 2020

<i>AU-C Section</i>	<i>Paragraphs Not Applicable to Compliance Audits</i>
<i>706, Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report</i>	Paragraphs .08–.09
<i>708, Consistency of Financial Statements</i>	All
<i>720, Other Information in Documents Containing Audited Financial Statements</i>	All
<i>725, Supplementary Information in Relation to the Financial Statements as a Whole</i>	All
<i>730, Required Supplementary Information</i>	All
<i>800, Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks</i>	All
<i>805, Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement</i>	All
<i>806, Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements</i>	All
<i>810, Engagements to Report on Summary Financial Statements</i>	All
<i>910, Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country</i>	All
<i>915, Reports on Application of Requirements of an Applicable Financial Reporting Framework</i>	All
<i>920, Letters for Underwriters and Certain Other Requesting Parties</i>	All
<i>925, Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933</i>	All
<i>930, Interim Financial Information</i>	All
<i>940, An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements</i>	All
945, Auditor Involvement With Exempt Offering Documents	All

Exhibit — Illustrative Combined Report on Compliance ~~With Applicable Requirements~~ and Internal Control Over Compliance — (Unmodified

Opinion on Compliance, No Material Weaknesses or Significant Deficiencies in Internal Control Over Compliance Identified)

~~.A4244~~ The following is an illustrative combined report on compliance with applicable requirements and internal control over compliance that contains the elements in paragraphs .30–.34. This illustrative report contains an unmodified opinion on compliance with no material weaknesses or significant deficiencies in internal control over compliance identified. The AICPA Audit Guide Government Auditing Standards and ~~Circular A-133~~ **Single Audits** contains illustrative language for other types of reports, including reports containing qualified or adverse opinions on compliance with either material weaknesses in internal control over compliance, significant deficiencies in internal control over compliance, or both identified.

Independent Auditor's Report

[Addressee]

Report on Compliance

Opinion on [indicate reporting level pursuant to governmental audit requirement]

We have audited Example Entity's compliance with the [identify the applicable compliance requirements or refer to the document that describes the applicable compliance requirements] applicable to Example Entity's [identify the government program(s) audited or refer to a separate schedule that identifies the program(s)] for the year ended June 30, 20X1.

~~Management's Responsibility~~

~~Compliance~~ **In our opinion, Example Entity complied, in all material respects,** with the requirements referred to above ~~is~~ **that are applicable to** [indicate reporting level pursuant to governmental audit requirement] **for the year ended June 30, 20X1.**

~~Auditor's Responsibility~~

Basis for Opinion

~~Our responsibility is to express an opinion on Example Entity's compliance based on our audit.~~

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America (**GAAS**); the standards applicable to financial audits contained in *Government Auditing Standards*^{fn+1} (**Government Auditing**

^{fn+1} The standards applicable to financial audits are in chapters 1–5 of *Government Auditing Standards*.

Standards) issued by the Comptroller General of the United States; and *[insert the name of the governmental audit requirement or program-specific audit guide]*. **Our responsibilities under those standards and *[insert the name of the governmental audit requirement or program-specific audit guide]* are further described in the Auditor’s Responsibilities for the Audit of Compliance section of our report.**

We are required to be independent of Example Entity and to meet our other ethical responsibilities, in accordance with relevant ethical requirements relating to our audit. We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion. Our audit does not provide a legal determination of Example Entity’s compliance with the compliance requirements referred to above.

Responsibilities of Management for Compliance

Management is responsible for compliance with the requirements referred to above and for designing, implementing, and maintaining effective internal control over compliance with the requirements of laws, statutes, regulations, rules, and provisions of contracts or grant agreements applicable to the entity’s government programs.

Auditor’s Responsibilities for the Audit of Compliance

~~Those standards and *[insert the name of the governmental audit requirement or program-specific audit guide]* require that we plan and perform the audit~~ **Our objectives are** to obtain reasonable assurance about whether **material** noncompliance with the compliance requirements referred to above that ~~could have a material effect on~~ **are applicable to** *[identify the government program(s) audited or refer to a separate schedule that identifies the program(s)]* occurred, **whether due to fraud or error, and express an opinion on compliance based on our** ~~An audit includes~~. **Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS, Government Auditing Standards; and *[insert the name of the governmental audit requirement or program-specific audit guide]* will always detect material noncompliance when it exists. The risk of not detecting material noncompliance resulting from fraud is higher than for that resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Noncompliance with the compliance requirements referred to above is considered quantitatively or qualitatively material to compliance if there is a substantial likelihood that, individually or in the aggregate, it would influence the judgment made by a reasonable user about compliance with the requirements of the government program as a whole based on the report on compliance.**

In performing an audit in accordance with GAAS, Government Auditing Standards, and [insert the name of the governmental audit requirement or program-specific audit guide], we

- *exercise professional judgment and maintain professional skepticism throughout the audit.*
- *identify and assess the risks of material noncompliance whether due to fraud or error and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence about regarding Example Entity's compliance with those applicable compliance requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Example Entity's compliance with those requirements.*

Opinion

- *In our opinion, Example Entity complied, in all material respects, obtain an understanding of with the compliance requirements referred to above and Example Entity's internal control over compliance relevant to the audit in order to design audit procedures that are applicable to appropriate in the circumstances and to test and report on internal control over compliance in accordance with [insert the name of the governmental audit requirement or program-specific audit guide] for the year ended June 30, 20X1, but not for the purpose of expressing an opinion on the effectiveness of Example Entity's internal control over compliance. Accordingly, no such opinion is expressed.*

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and any significant deficiencies and material weaknesses in internal control over compliance that we identified during the audit.

Report on Internal Control Over Compliance

~~Management of Example Entity is responsible for establishing and maintaining effective internal control over compliance with the compliance requirements referred to above. In planning and performing our audit, we considered Example Entity's internal control over compliance to determine the auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Example Entity's internal control over compliance.~~

A deficiency in internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance on a timely basis. A material weakness in internal control over compliance is a deficiency, or

combination of deficiencies in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a compliance requirement will not be prevented, or detected and corrected, on a timely basis. **A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.**

Our consideration of internal control over compliance was for the limited purpose described in the Auditor's Responsibilities for the Audit of Compliance section above and was not designed to identify all deficiencies in internal control **over compliance** that might be ~~deficiencies, significant deficiencies, or~~ material weaknesses **or significant deficiencies** in internal control over compliance. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. **However, material weaknesses in internal control over compliance may exist that have not been identified.**

Our audit was not designed for the purpose of expressing an opinion on the effectiveness of internal control over compliance, ~~and we do not express an~~. **Accordingly, no such opinion on the effectiveness of Example Entity's internal control over compliance is expressed.**

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the [*insert the name of the governmental audit requirement or program-specific audit guide*]. Accordingly, this report is not suitable for any other purpose.

[**Signature of the auditor's firm**]

[**City and state where the auditor's report is issued**]

[**Date of the auditor's report**]

4. This amendment is effective for compliance audits for fiscal periods ending on or after December 15, 2020. Early implementation is not permitted.

Proposed Amendment to AU-C Section 940

AU-C Section 940, An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements

[No proposed amendment to paragraphs .01–.63.]

.64 The auditor's report on the audit of ICFR should be in writing and should include the following elements:

- a. **Title.** *The auditor's report should have a title that includes the word ~~independent~~ to clearly indicate ~~indicates~~ that it is the report of an independent auditor.*
- b. **Addressee.** *An addressee as required by the ~~The auditor's report should be addressed, as appropriate, based on the~~ circumstances of the engagement.*
- c. **Auditor's Opinion on ICFR.** *An introductory paragraph that includes the following: ~~The first section of the auditor's report should include the auditor's opinion on ICFR and should have the heading "Opinion on Internal Control Over Financial Reporting." The "Opinion on Internal Control Over Financial Reporting" section of the auditor's report should also do the following:~~*
 - i. ~~Identification of~~ *Identify* the entity whose ICFR has been audited
 - ii. ~~A statement~~ *State* that the entity's ICFR has been audited
 - iii. ~~Identification of~~ *Identify* the as of date
 - iv. ~~Identification of~~ *Identify* the criteria against which ICFR is measured
 - v. *Include the auditor's opinion on whether the entity maintained, in all material respects, effective ICFR as of the specified date, based on the criteria*
- d. **Basis for Opinion.** *The auditor's report should include a section, directly following the "Opinion on Internal Control Over Financial Reporting" section, with the heading "Basis for Opinion," that does the following:*
 - i. *States that the audit was conducted in accordance with generally accepted auditing standards (GAAS) and identifies the United States of America as the country of origin of those standards (Ref: par. .A113)*
 - ii. *Refers to the section of the auditor's report that describes the auditor's responsibilities under GAAS*

- iii. *Includes a statement that the auditor is required to be independent of the entity and to meet the auditor's other ethical responsibilities, in accordance with the relevant ethical requirements relating to the audit*⁷

⁷ See paragraphs .A38–.A39 of section 700, Forming an Opinion and Reporting on Financial Statements.

[Subsequent footnotes renumbered.]

- iv. *States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion*
- ed. **Responsibilities of Management.** *The auditor's report should include a* ~~A~~-section with the heading "**Responsibilities of Management's Responsibility** for Internal Control Over Financial Reporting." *This section of the auditor's report should do that includes the following:*
 - i. ~~A statement~~ *State* that management is responsible for designing, implementing, and maintaining effective ICFR
 - ii. ~~A statement~~ *State* that management is responsible for its assessment about the effectiveness of ICFR
 - iii. ~~A~~ *Include a* reference to management's report on ICFR
- fe. **Auditor's Responsibilities.** *The auditor's report should include a* ~~A~~-section with the heading "**Auditor's Responsibilities for the Audit of Internal Control Over Financial Reporting Responsibility**." *This section of the auditor's report should do that includes the following:*
 - i. *State that the objectives of the auditor are to*
 - (1) *obtain reasonable assurance about whether effective ICFR was maintained in all material respects*
 - i(2) ~~A statement that the~~ *issue an auditor's report responsibility is to express an* ~~that includes the auditor's opinion on the entity's ICFR based on the audit~~
 - ii. ~~A statement that the audit was conducted in accordance with auditing standards generally accepted in the United States of America (Ref: par. .A113)~~
 - iii. ~~A statement that such standards require that the auditor plan and perform the audit to obtain reasonable assurance about whether effective ICFR was maintained in all material respects~~

- ii. *State that internal control over financial reporting is not effective if a material weakness exists*
- iii. *State that reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit of internal control over financial reporting conducted in accordance with GAAS will always detect a material weakness when it exists*
- iv. ~~A description of~~ *Describe* the audit by stating that, *in performing an audit of ICFR in accordance with GAAS, the auditor's responsibilities are to*
 - (1) exercise professional judgment and maintain professional skepticism throughout the audit*
 - ~~(1) an audit of ICFR involves performing procedures to obtain audit evidence about whether a material weakness exists~~
 - ~~(2) the procedures selected depend on the auditor's judgment, including the assessment of the risks that a material weakness exists~~
 - (2) (3) an audit includes obtaining obtain an understanding of ICFR, assess the risks that a material weakness exists, and test and evaluate and testing and evaluating the design and operating effectiveness of ICFR based on the assessed risk*
- v. ~~A statement about whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the audit opinion~~

Definition and Inherent Limitations of Internal Control Over Financial Reporting

- g. ~~f.~~ *The auditor's report should include* a section with the heading "Definition and Inherent Limitations of Internal Control Over Financial Reporting" or other appropriate heading that includes the following:
 - i. A definition of ICFR (the auditor should use the same description of the entity's ICFR as management uses in its report)
 - ii. A paragraph stating that because of inherent limitations, ICFR may not prevent, or detect and correct, misstatements and that projections of any assessment of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate
- 1. ~~g.~~ A section with the heading "Opinion" that includes the auditor's opinion on whether the entity maintained, in all material respects, effective ICFR as of the specified date, based on the criteria
- h. **Signature of the Auditor.** ~~The manual or printed signature of the auditor's firm~~ *auditor's report should include the manual or printed signature of the auditor's firm.*

- i. **Auditor's Address.** The *auditor's report should name the* city and state where the ~~auditor practices~~ *auditor's report is issued.*
- j. **Date of the Auditor's Report.** ~~The date of the auditor's report~~ *should be dated, as required by paragraph .66.*

[Subsequent footnotes renumbered.]

Separate Report on ICFR

.65 If the auditor issues a separate report on ICFR, the auditor should add the following paragraph, ~~in an other matter paragraph with an appropriate heading, in accordance with section 706, *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*~~ *following the opinion paragraph within the "Opinion" section*, to the auditor's report on the financial statements:

We also have audited, in accordance with auditing standards generally accepted in the United States of America, [entity name]'s internal control over financial reporting as of December 31, 20X8, based on [identify criteria] and our report dated [date of report, which should be the same as the date of the report on the financial statements] expressed [include nature of opinion].

The auditor also should add the following ~~other matter paragraph~~ *paragraph, following the opinion paragraph within the "Opinion on Internal Control Over Financial Reporting" section*, to the report on ICFR:

We also have audited, in accordance with auditing standards generally accepted in the United States of America, the [identify financial statements] of [entity name] and our report dated [date of report, which should be the same as the date of the report on the audit of ICFR] expressed [include nature of opinion]. (Ref: par. .A114-.A116)

Report Date

.66 The auditor should date the report on ICFR no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence *on which* to ~~support~~ *base* the auditor's opinion, ~~including evidence that the audit documentation has been reviewed.~~ Because the audit of ICFR is integrated with the audit of the financial statements, when issuing separate reports on the entity's financial statements and on ICFR, the dates of the reports should be the same. (*Ref: par. .A116*)

Report Modifications

[No proposed amendment to paragraphs .67-.68.]

.69 ~~.71~~ The auditor should determine the effect an adverse opinion on ICFR has on the auditor's opinion on the financial statements. Additionally, the auditor should disclose, *as a separate paragraph within the "Adverse Opinion on Internal Control Over Financial Reporting" section*

~~to the report on ICFR, in an other matter paragraph or as part of the paragraph that identifies the material weakness, whether the auditor's opinion on the financial statements was affected by the material weakness. (Ref: par. .A120-A124)~~

~~.70~~ **.69** When ICFR is not effective because one or more material weaknesses exist, the auditor's report should include *the following in the "Basis for Adverse Opinion on Internal Control Over Financial Reporting" section:*

- a. The definition of a material weakness
- b. A statement that one or more material weaknesses have been identified and an identification of the material weaknesses described in management's assessment about ICFR. (Ref: par. ~~.A121-A120~~)

~~.71~~ **.70** If one or more material weaknesses have not been included in management's report accompanying the auditor's report, the auditor's report should be modified to state that one or more material weaknesses have been identified but not included in management's report. Additionally, the auditor's report should include a description of each material weakness not included in management's report. The auditor's description should include specific information about the nature of each material weakness and its actual and potential effect on the presentation of the entity's financial statements issued during the existence of the weakness. In this case, the auditor also should communicate, in writing, to those charged with governance that one or more material weaknesses were not disclosed or identified as a material weakness in management's report. If one or more material weaknesses have been included in management's report but the auditor concludes that the disclosure of such material weaknesses is not fairly presented in all material respects, the auditor's report should describe this conclusion as well as the information necessary to fairly describe each material weakness.

[No proposed amendment to paragraphs .72-.74.]

.75 When disclaiming an opinion because of a scope limitation, the auditor should state that the auditor does not express an opinion on the effectiveness of ICFR ~~and~~ *within the "Disclaimer of Opinion on Internal Control Over Financial Reporting" section and state* the substantive reasons for the disclaimer; ~~within the "Basis for Disclaimer of Opinion on Internal Control Over Financial Reporting" section.~~ The auditor *should amend the basis of opinion and auditor's responsibilities sections and* should not identify the procedures that were performed nor include the statements describing the characteristics of an audit of ICFR, as described in paragraph ~~.64d(i), paragraph .64d(ii), paragraph .64d(iv), and paragraph .64f;~~ to do so might overshadow the disclaimer. (Ref: par. ~~.A123-.A124~~)

.76 When the auditor disclaims an opinion but has concluded that one or more material weaknesses exist, the auditor's report also should include *the following in the "Basis for Disclaimer of Opinion on Internal Control Over Financial Reporting" section:*

- a. ~~T~~he definition of a material weakness

b. A statement that one or more material weaknesses have been identified and an identification of the material weaknesses described in management's assessment about ICFR

bc. A ~~a~~ description of ~~any~~ the material weaknesses identified in the entity's ICFR. This description should address the requirements in paragraph .69 and should provide the users of the report with specific information about the nature of any material weakness and its actual and potential effect on the presentation of the entity's financial statements issued during the existence of the weakness.

The auditor also should apply the requirements in ~~paragraph~~ ***paragraphs .69 and .71.*** (Ref: par. .A125)

[No proposed amendment to paragraphs .77-.79.]

Additional Information

.80 When management includes, either within management's report or in a document containing management's report ***and the related auditor's report***, information in addition to the elements that are subject to the auditor's evaluation as described in paragraph .55, the auditor should ***do the following***:

- a. When such information is included in management's report, read the additional information to identify material inconsistencies with management's report and to become aware of material misstatements of fact. If no material inconsistencies or material misstatements of fact are identified, disclaim an opinion, in an other-matter paragraph, on the additional information. If, upon reading the additional information the auditor identifies a material inconsistency or becomes aware of a material misstatement of fact, request management to correct the information. If management agrees to make the correction, determine that the correction has been made. If management refuses to make the correction, communicate the matter to those charged with governance and request that the correction be made. If the correction is not made after communicating with those charged with governance, the auditor should do one or more of the following:*** (Ref: par. .A129)
 - i. Consider the implications for the auditor's report and communicate to those charged with governance about how the auditor plans to address the material inconsistency or material misstatement of fact in the auditor's report***
 - ii. Withhold the auditor's report***
 - iii. Withdraw from the engagement, when withdrawal is possible under the applicable law or regulation***

- b. *When such information is included outside management's report and the related auditor's report*, read the additional information to identify material inconsistencies with management's report. If, upon reading the additional information, the auditor *identifies a* material inconsistency or *becomes aware of a material* misstatement of fact, *request management to correct the information. If management agrees to make the correction, determine that the correction has been made. If management refuses to make the correction, communicate the matter to those charged with governance and request that the correction be made. If the correction is not made after communicating with those charged with governance, the auditor should do one or more of the following:* (Ref: par. .A130)
- i. *Consider the implications for the auditor's report and communicate to those charged with governance about how the auditor plans to address the material inconsistency or material misstatement of fact in the auditor's report*
 - ii. *Withhold the auditor's report*
 - iii. *Withdraw from the engagement, when withdrawal is possible under the applicable law or regulation*

SPECIAL TOPICS

Entities With Multiple Components

[No proposed amendment to paragraphs .81–.83.]

Special Situations

[No proposed amendment to paragraphs .84–.85.]

.86 In situations in which management elects to limit its assessment by excluding certain entities, the auditor should evaluate whether it is appropriate, in the auditor's judgment, to do so. If the auditor concludes that it is appropriate, ***in applying the requirement in paragraph .64d***, the auditor should include ~~in the introductory paragraph of the report~~ a disclosure similar to management's regarding the exclusion of an entity from the scope of both management's assessment about ICFR and the auditor's audit of ICFR. Additionally, the auditor should evaluate the appropriateness of management's disclosure related to such a limitation. (Ref: par. .A136)

[No proposed amendment to paragraphs .87–.A113. Paragraphs .A113 and .A115–.A116 included for contextual purposes.]

Application and Other Explanatory Material

...

Reporting on ICFR (Ref: par. .64-.65)

Considerations Specific to Governmental Entities

.A113 When the audit is also conducted in accordance with *Government Auditing Standards* (also known as the Yellow Book), the auditor may state that the audit was conducted in accordance with the auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. If significant deficiencies in ICFR are identified in such an audit and the auditor's report refers to *Government Auditing Standards*, those standards require the auditor to report such deficiencies. The following is an illustration of that communication through the addition of other-matter paragraphs to the auditor's report:

In accordance with *Government Auditing Standards*, we are required to report findings of significant deficiencies. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies in ABC Company's internal control described below [*or in the accompanying schedule of findings*] to be significant deficiencies.

ABC Company's response to the findings identified in our audit is described below [*or in the accompanying schedule of findings*]. We did not audit ABC Company's response and, accordingly, we express no opinion on the response.

~~.A114~~ When an other matter paragraph relating to ICFR is included in a financial statement audit report, the auditor may include a heading above the other matter paragraph such as "Report on Internal Control Over Financial Reporting." When an other matter paragraph relating to the financial statement audit is included in an ICFR report, the auditor may include a heading above the other matter paragraph such as "Report on the Financial Statements."

~~.A114~~.A115 The auditor may choose to issue a combined report (that is, one report containing both an opinion on the financial statements and an opinion on ICFR) or separate reports on the entity's financial statements and on ICFR.

~~.A115~~.A116 If the auditor issues a separate report on ICFR and expresses an adverse opinion on ICFR, the disclosure required by paragraph ~~.69~~.71 related to the effect of the adverse opinion on ICFR on the auditor's opinion on the financial statements may be combined with the report language described in paragraph .65.

.A116 *AU-C section 220, Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards, requires that, on or before the date of the auditor's report, the engagement partner, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued.²⁵ When an engagement quality control review is performed, AU-C section 220 requires that the auditor's report not be released prior to the completion of the engagement quality control review.²⁶*

²⁵ See paragraph .19 of AU-C section 220, Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards, for further discussion.

²⁶ Paragraph .21 of AU-C section 220.

[Subsequent footnotes further renumbered. No proposed amendment to paragraphs .A117–.A119.]

~~.A120-A124~~ As described in paragraph ~~.A115.A116~~, if the auditor issues a separate report on ICFR in this circumstance, the disclosure required by paragraph ~~.69-74~~ may be combined with the report language described in paragraph .65.

~~.A121-A120~~ The auditor's report need only refer to the "material weaknesses described in management's report" and need not include a description of each material weakness, provided each material weakness is included and fairly presented in all material respects in management's report, as described in paragraph ~~.71-70~~.

[No proposed amendment to paragraphs .A122–.A153.]

EXHIBIT A — ILLUSTRATIVE REPORTS

.A154 The following illustrate the report elements described in this section. The illustrations assume that the audit of internal control over financial reporting (ICFR) and the audit of the financial statements were performed by the same auditor. Report modifications are discussed beginning in paragraph .67 of this section.

Illustration 1 — Unmodified Opinion on ICFR

Illustration 2 — Adverse Opinion on ICFR

Illustration 3 — Disclaimer of Opinion on ICFR

Illustration 4 — Unmodified Opinion on ICFR Making Reference to a Component Auditor

Illustration 5 — Combined Report Expressing an Unmodified Opinion on ICFR and an Unmodified Opinion on the Financial Statements

Illustration 1 — Unmodified Opinion on ICFR

The following is an illustrative report expressing an unmodified opinion on ICFR.

Independent Auditor's Report

[Appropriate Addressee]

Report on Internal Control Over Financial Reporting¹

Opinion on Internal Control Over Financial Reporting

We have audited ABC Company's internal control over financial reporting as of December 31, 20XX, based on *[identify criteria]*.² ***In our opinion, ABC Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 20XX, based on [identify criteria].***

Management's Responsibility for Internal Control Over Financial Reporting

~~Management is responsible for designing, implementing, and maintaining effective internal control over financial reporting, and for its assessment about the effectiveness of internal control over financial reporting, included in the accompanying *[title of management's report]*.~~

Auditor's Responsibility

We also have audited, in accordance with auditing standards generally accepted in the United States of America (GAAS), the [identify financial statements] of ABC Company, and our report dated [date of report, which should be the same as the date of the report on the audit of ICFR] expressed [include nature of opinion].

¹ The subtitle "Report on Internal Control Over Financial Reporting" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

² For example, the following may be used to identify the criteria: "criteria established in the *Internal Control—Integrated Framework* (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)."

Basis for Opinion

We conducted our audit in accordance with ~~GAAS auditing standards generally accepted in the United States of America.~~ *Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of Internal Control Over Financial Reporting section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.*

Responsibilities of Management for Internal Control Over Financial Reporting

Management is responsible for designing, implementing, and maintaining effective internal control over financial reporting, and for its assessment about the effectiveness of internal control over financial reporting, included in the accompanying [title of management's report].

~~. Those standards require that we plan and perform the audit~~

Auditor's Responsibilities for the Audit of Internal Control Over Financial Reporting

Our objectives are to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects— and to issue an auditor's report that includes our opinion on internal control over financial reporting. An audit of internal control over financial reporting is not effective if involves performing procedures to obtain audit evidence about whether a material weakness exists. The procedures selected depend on the auditor's Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit of internal control over financial reporting conducted in accordance with GAAS will always detect a material weakness when it exists.

In performing an audit of internal control over financial reporting in accordance with GAAS, we:

- *Exercise professional judgment, including the assessment of the risks that a material weakness exists. An audit includes obtaining and maintain professional skepticism throughout the audit.*
- *Obtain an understanding of internal control over financial reporting, assess the risks that a material weakness exists, and testing—test and evaluating—evaluate the design and operating effectiveness of internal control over financial reporting based on the assessed risk.*

~~We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.~~

Definition and Inherent Limitations of Internal Control Over Financial Reporting

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with [*applicable financial reporting framework, such as accounting principles generally accepted in the United States of America*]. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with [*applicable financial reporting framework, such as accounting principles generally accepted in the United States of America*], and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements. Also, projections of any assessment of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]

Opinion

~~In our opinion, ABC Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 20XX, based on [*identify criteria*].~~

Report on Financial Statements

~~We also have audited, in accordance with auditing standards generally accepted in the United States of America, the [*identify financial statements*] of ABC Company, and our report dated [*date of report, which should be the same as the date of the report on the audit of ICFR*] expressed [*include nature of opinion*].~~

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]

[Auditor's signature] **[Signature of the auditor's firm]**

[Auditor's City and state where the auditor's report is issued]

[Date of the auditor's report]

Illustration 2 — Adverse Opinion on ICFR

The following is an illustrative report expressing an adverse opinion on ICFR. In this example, the opinion on the financial statements is not affected by the adverse opinion on ICFR.

Independent Auditor's Report

[Appropriate Addressee]

Report on Internal Control Over Financial Reporting¹

Adverse Opinion on Internal Control Over Financial Reporting

We have audited ABC Company's internal control over financial reporting as of December 31, 20XX, based on [identify criteria].² *In our opinion, because of the effect of the material weakness described in the Basis for Adverse Opinion section on the achievement of the objectives of [identify criteria], ABC Company has not maintained effective internal control over financial reporting as of December 31, 20XX, based on [identify criteria].*

We also have audited, in accordance with auditing standards generally accepted in the United States of America (GAAS), the [identify financial statements] of ABC Company, and our report dated [date of report, which should be the same as the date of the report on the audit of ICFR] expressed [include nature of opinion].

We considered the material weakness described in the Basis for Adverse Opinion on Internal Control Over Financial Reporting section in determining the nature, timing, and extent of audit procedures applied in our audit of the 20XX financial statements, and this report does not affect such report on the financial statements.

Basis for Adverse Opinion on Internal Control Over Financial Reporting

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely

¹ The subtitle "Report on Internal Control Over Financial Reporting" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

² For example, the following may be used to identify the criteria: "criteria established in the *Internal Control—Integrated Framework* (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)."

basis. The following material weakness has been identified and included in the accompanying [title of management's report].

[Identify the material weakness described in management's report.]³

We conducted our audit in accordance with GAAS. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of Internal Control Over Financial Reporting section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management ~~Management's Responsibility~~ for Internal Control Over Financial Reporting

Management is responsible for designing, implementing, and maintaining effective internal control over financial reporting, and for its assessment about the effectiveness of internal control over financial reporting, included in the accompanying [title of management's report].

Auditor's ~~Responsibility~~ Responsibilities for the Audit of Internal Control Over Financial Reporting

Our *objectives are to* responsibility is to express an opinion on the entity's internal control over financial reporting based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects *and to issue an auditor's report that includes our opinion on internal control over financial reporting*. An audit of internal control over financial reporting *is not effective if* involves performing procedures to obtain evidence about whether a material weakness exists. *Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit of internal control over financial reporting conducted in accordance with GAAS will always detect a material weakness when it exists.*

In performing an audit of internal control over financial reporting in accordance with GAAS, we:

³ See paragraphs .68-.71 of this section for specific reporting requirements. The auditor's report need only refer to the material weaknesses described in management's report and need not include a description of each material weakness, provided each material weakness is included and fairly presented in all material respects in management's report.

- ***Exercise professional judgment and maintain professional skepticism throughout the audit***
- ***Obtain*** ~~The procedures selected depend on the auditor's judgment, including the assessment of the risks that a material weakness exists. An audit includes obtaining an understanding of internal control over financial reporting, ***assess the risks that a material weakness exists***, and ***test*** testing and ***evaluate*** evaluating the design and operating effectiveness of internal control over financial reporting based on the assessed risk.~~

~~We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse audit opinion.~~

Definition and Inherent Limitations of Internal Control Over Financial Reporting

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with [*applicable financial reporting framework, such as accounting principles generally accepted in the United States of America*]. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with [*applicable financial reporting framework, such as accounting principles generally accepted in the United States of America*], and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction, of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements. Also, projections of any assessment of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]

Adverse Opinion

~~In our opinion, because of the effect of the material weakness described in the Basis for Adverse Opinion paragraph on the achievement of the objectives of [*identify criteria*], ABC Company has~~

~~not maintained effective internal control over financial reporting as of December 31, 20XX, based on [identify criteria].~~

Report on Financial Statements

~~We considered the material weakness identified above in determining the nature, timing, and extent of audit procedures applied in our audit of the 20XX financial statements, and this report does not affect such report on the financial statements.~~

~~[Auditor's signature]~~

~~[Auditor's **Signature of the auditor's firm**]~~

~~[City and state where the auditor's report is issued]~~

~~[Date of the auditor's report]~~

Illustration 3 — Disclaimer of Opinion on ICFR

The following is an illustrative report expressing a disclaimer of opinion on ICFR. In this example, the auditor is applying paragraph .76 of this section because a material weakness was identified during the limited procedures performed by the auditor.

Independent Auditor's Report

[Appropriate Addressee]

Report on Internal Control Over Financial Reporting¹

Disclaimer of Opinion on Internal Control Over Financial Reporting

We were engaged to audit ABC Company's internal control over financial reporting as of December 31, 20XX, based on [identify criteria].² ***Because of the significance of the matter described in the Basis for Disclaimer of Opinion on Internal Control Over Financial Reporting section, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the effectiveness of ABC Company's internal control over financial reporting.***

We have audited, in accordance with auditing standards generally accepted in the United States of America (GAAS), the [identify financial statements] of ABC Company, and our report dated [date of report, which should be the same as the date of the report on the audit of ICFR] expressed [include nature of opinion].

We considered the material weakness described in the Basis for Disclaimer of Opinion on Internal Control Over Financial Reporting section in determining the nature, timing, and extent of audit procedures applied in our audit of the 20XX financial statements, and this report does not affect such report on the financial statements.

Basis for Disclaimer of Opinion on Internal Control Over Financial Reporting

[Provide description of the matter giving rise to the disclaimer of opinion]

¹ The subtitle "Report on Internal Control Over Financial Reporting" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

² For example, the following may be used to identify the criteria: "criteria established in the *Internal Control—Integrated Framework* (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)."

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. If one or more material weaknesses exist, an entity's internal control over financial reporting cannot be considered effective. The following material weakness has been included in the accompanying [title of management's report].

[Identify the material weakness described in management's report and include a description of the material weakness, including its nature and actual and potential effect on the presentation of the entity's financial statements issued during the existence of the material weakness.]

Responsibilities of Management ~~Management's Responsibility~~ for Internal Control Over Financial Reporting

Management is responsible for designing, implementing, and maintaining effective internal control over financial reporting and for its assessment about the effectiveness of internal control over financial reporting included in the accompanying [title of management's report].

Auditor's ~~Responsibility~~ Responsibilities for the Audit of Internal Control Over Financial Reporting

Our responsibility is to ***conduct an audit of*** ~~express an opinion on~~ ABC Company's internal control over financial reporting ~~based on conducting the audit~~ in accordance with ~~GAAS auditing standards generally accepted in the United States of America.~~ ***However, because*** ~~Because of the~~ matter described in the Basis for Disclaimer of Opinion ***on Internal Control Over Financial Reporting section*** ~~paragraph, however,~~ we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit.

Definition and Inherent Limitations of Internal Control Over Financial Reporting

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with [applicable financial reporting framework, such as accounting principles generally accepted in the United States of America]. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements

in accordance with [*applicable financial reporting framework, such as accounting principles generally accepted in the United States of America*], and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements. Also, projections of any assessment of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Basis for Disclaimer of Opinion

[Provide a description of the matter giving rise to the disclaimer of opinion.]

Material Weakness

~~Because of the matter described above, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. However, A material weakness has been identified. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. If one or more material weaknesses exist, an entity's internal control over financial reporting cannot be considered effective. The following material weakness has been included in the accompanying [title of management's report].~~

[Identify the material weakness described in management's report and include a description of the material weakness, including its nature and its actual and potential effect on the presentation of the entity's financial statements issued during the existence of the material weakness.]

Disclaimer of Opinion

~~Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the effectiveness of ABC Company's internal control over financial reporting.~~

Report on Financial Statements

~~We have audited, in accordance with auditing standards generally accepted in the United States of America, the [*identify financial statements*] of ABC Company, and our report dated [*date of report*,~~

~~which should be the same as the date of the report on the audit of ICFR] expressed [include nature of opinion]. We considered the material weakness identified above in determining the nature, timing, and extent of audit procedures applied in our audit of the 20XX financial statements, and this report does not affect such report on the financial statements.~~

Report on Other Legal and Regulatory Requirements

~~[The form *Form* and content of this section of the auditor's report would *will* vary depending on the nature of the auditor's other reporting responsibilities.]~~

~~[Signature of the auditor's firm *Auditor's signature*]~~

~~[*Auditor's city* City and state where the auditor's report is issued]~~

~~[Date of the auditor's report]~~

Illustration 4 — Unmodified Opinion on ICFR Making Reference to a Component Auditor

The following is an illustrative report expressing an unmodified opinion on ICFR when the engagement partner decides to make reference to the report of a component auditor.

Independent Auditor's Report

[Appropriate Addressee]

Report on Internal Control Over Financial Reporting¹

Opinion on Internal Control Over Financial Reporting

We have audited ABC Company's internal control over financial reporting as of December 31, 20XX, based on [identify criteria].² ***In our opinion, based on our audit and the report of the other auditors, ABC Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 20XX, based on [identify criteria].***

We did not audit the effectiveness of internal control over financial reporting of B Company, a wholly owned subsidiary, whose financial statements reflect total assets and revenues constituting 20 percent and 30 percent, respectively, of the related consolidated financial statement amounts as of and for the year ended December 31, 20XX. The effectiveness of B Company's internal control over financial reporting was audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the effectiveness of B Company's internal control over financial reporting, is based solely on the report of the other auditors.

We also have audited, in accordance with auditing standards generally accepted in the United States of America (GAAS), the [identify financial statements] of ABC Company, and our report dated [date of report, which should be the same as the date of the report on the audit of ICFR] expressed [include nature of opinion], based on our audit and the report of the other auditors.

Basis for Opinion

¹ The subtitle "Report on Internal Control Over Financial Reporting" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

² For example, the following may be used to identify the criteria: "criteria established in the *Internal Control—Integrated Framework* (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)."

We conducted our audit in accordance with GAAS. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of Internal Control Over Financial Reporting section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Management's ~~Responsibility~~ **Responsibilities for the Audit of Internal Control Over Financial Reporting**

Management is responsible for designing, implementing, and maintaining effective internal control over financial reporting and for its assessment about the effectiveness of internal control over financial reporting included in the accompanying [title of management's report].

Auditor's ~~Responsibility~~ **Responsibilities for the Audit of Internal Control Over Financial Reporting**

Our objectives are to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects and to issue an auditor's report that includes our opinion on internal control over financial reporting. Internal control over financial reporting is not effective if a material weakness exists. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit of internal control over financial reporting conducted in accordance with GAAS will always detect a material weakness when it exists.

In performing an audit of internal control over financial reporting in accordance with GAAS, we:

- *Exercise professional judgment and maintain professional skepticism throughout the audit.*
- *Obtain an understanding of internal control over financial reporting, assess the risks that a material weakness exists, and test and evaluate the design and operating effectiveness of internal control over financial reporting based on the assessed risk.*

~~Our responsibility is to express an opinion on the entity's internal control over financial reporting based on our audit. We did not audit the effectiveness of internal control over financial reporting of B Company, a wholly owned subsidiary, whose financial statements reflect total assets and revenues constituting 20 percent and 30 percent, respectively, of the related consolidated financial statement amounts as of and for the year ended December 31, 20XX. The effectiveness of B Company's internal control over financial reporting was audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the effectiveness of B Company's internal control over financial reporting, is based solely on the report of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States~~

~~of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.~~

~~An audit of internal control over financial reporting involves performing procedures to obtain audit evidence about whether a material weakness exists. The procedures selected depend on the auditor's judgment, including the assessment of the risks that a material weakness exists. An audit includes obtaining an understanding of internal control over financial reporting and testing and evaluating the design and operating effectiveness of internal control over financial reporting based on the assessed risk.~~

~~We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.~~

Definition and Inherent Limitations of Internal Control Over Financial Reporting

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with [*applicable financial reporting framework, such as accounting principles generally accepted in the United States of America*]. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with [*applicable financial reporting framework, such as accounting principles generally accepted in the United States of America*], and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements. Also, projections of any assessment of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Opinion

~~In our opinion, based on our audit and the report of the other auditors, ABC Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 20XX, based on [*identify criteria*].~~

Report on Financial Statements

We also have audited, in accordance with auditing standards generally accepted in the United States of America, the *[identify financial statements]* of ABC Company, and our report dated *[date of report, which should be the same as the date of the report on the audit of ICFR]* expressed *[include nature of opinion]*, based on our audit and the report of the other auditors.

Report on Other Legal and Regulatory Requirements

[The form ~~Form~~ and content of this section of the auditor's report **would** ~~will~~ vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of the auditor's firm ~~Auditor's signature~~]

[~~Auditor's city~~ City and state **where the auditor's report is issued**]

[Date of the auditor's report]

Illustration 5 — Combined Report Expressing an Unmodified Opinion on ICFR and an Unmodified Opinion on the Financial Statements

The following is an illustrative combined report expressing an unmodified opinion on ICFR and an unmodified opinion on the financial statements. The circumstances include *the following*:

- An audit of a complete set of general purpose financial statements (single year) prepared). *The audit is not a group audit.*
- *Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America, as promulgated by the Financial Accounting Standards Board.*
- *The terms of the audit engagement reflect the description of management's responsibility for the financial statements in AU-C section 210, Terms of Engagement.*
- *The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.*
- *Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with AU-C section 570, The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern.*
- *The auditor has not been engaged to communicate key audit matters.*

Independent Auditor's Report

[Appropriate Addressee]

Report on the Financial Statements and Internal Control Over Financial Reporting¹

Opinions on the Financial Statements and Internal Control Over Financial Reporting

We have audited the ~~accompanying~~ financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements. *In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20XX, and the results of*

¹ The subtitle "Report on the Financial Statements and Internal Control *Over Financial Reporting*" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

We also have audited ABC Company's internal control over financial reporting as of December 31, 20XX, based on [identify criteria].² ***In our opinion, ABC Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 20XX, based on [identify criteria].***

Basis for Opinions

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audits of the Financial Statements and Internal Control Over Financial Reporting section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Management's Responsibility Responsibilities of Management for the Financial Statements and Internal Control Over Financial Reporting

Management is responsible for the preparation and fair presentation of ~~these~~***the*** financial statements in accordance with accounting principles generally accepted in the United States of America, ***and for*** the design, implementation, and maintenance of effective internal control over financial reporting relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. Management is also responsible for its assessment about the effectiveness of internal control over financial reporting, included in the accompanying [title of management's report].

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern [insert the time period set by the applicable financial reporting framework].

Auditor's Responsibility Responsibilities for the Audits of the Financial Statements and Internal Control Over Financial Reporting

~~Our responsibility is to express an opinion on these financial statements and an opinion on the entity's internal control over financial reporting based on our audits. We conducted our audits in~~

² For example, the following may be used to identify the criteria: "criteria established in the *Internal Control—Integrated Framework* (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)."

~~accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits~~ ***Our objectives are*** to obtain reasonable assurance about whether the financial statements ***as a whole*** are free from material misstatement ~~and, whether~~ ***due to fraud or error, and about whether*** effective internal control over financial reporting was maintained in all material respects, ***and to issue an auditor's report that includes our opinions.*** ~~An audit of~~ ***Internal control over*** financial statements ~~reporting is not effective if involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's~~ ***a material weakness exists.***

Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit of financial statements or an audit of internal control over financial reporting conducted in accordance with GAAS will always detect a material misstatement or a material weakness when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements, including omissions, are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit of financial statements and an audit of internal control over financial reporting in accordance with GAAS, we:

- ***Exercise professional judgment, including the assessment of and maintain professional skepticism throughout the audits.***
- ***Identify and assess*** the risks of material misstatement of the financial statements, whether due to fraud or error. ~~In making,~~ ***and design and perform audit procedures responsive to those risk assessments, risks. Such procedures include examining, on a test basis, evidence regarding*** the auditor ~~considers~~ ***amounts and disclosures in the financial statements.***
- ***Obtain an understanding of*** internal control relevant to the entity's ~~preparation and fair presentation of the financial statements~~ ***statement audit*** in order to design audit procedures that are appropriate in the circumstances. ~~An audit of financial statements also includes evaluating~~
- ***Obtain an understanding of internal control over financial reporting relevant to the audit of internal control over financial reporting, assess the risks that a material weakness exists, and test and evaluate the design and operating effectiveness of internal control over financial reporting based on the assessed risk.***
- ***Evaluate*** the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as ~~evaluating~~ ***evaluate*** the overall presentation of the financial statements.

~~An audit of internal control over financial reporting involves performing procedures to obtain evidence about whether a material weakness exists. The procedures selected depend on the auditor's judgment, including the assessment of the risk that a material weakness exists. An audit of internal control over financial reporting also involves obtaining an understanding of internal control over financial reporting and testing and evaluating the design and operating effectiveness of internal control over financial reporting based on the assessed risk.~~

- *Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.*

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the financial statement audit.

Definition and Inherent Limitations of Internal Control Over Financial Reporting

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements. Also, projections of any assessment of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Opinions

~~In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of ABC Company as of December 31, 20XX, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America. Also, in our opinion, ABC Company maintained, in all~~

~~material respects, effective internal control over financial reporting as of December 31, 20XX,
based on [identify criteria].~~

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]

~~[Auditor's signature]~~

~~[Auditor's~~ **Signature of the auditor's firm]**

~~[City and state~~ **where the auditor's report is issued]**

~~[Date of the auditor's report]~~

[No proposed amendment to paragraph .A155–.A156.]

EXHIBIT D — REPORTING UNDER SECTION 112 OF THE FEDERAL DEPOSIT INSURANCE CORPORATION IMPROVEMENT ACT

.A157

[No proposed amendment to paragraph 1.]

Definition of ICFR for FDICIA Purposes

2. In accordance with paragraph .64g of this section, the auditor's report is required to include a definition of ICFR that uses the same description of ICFR that management uses in its report. The following is an illustrative definition paragraph that may be used when an IDI that is an insured bank (which is not subject to Section 404 of the Sarbanes-Oxley Act of 2002) elects to report on controls for FDICIA purposes at the bank holding company level:

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America. Because management's assessment and our audit were conducted to meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), our audit of [*Holding Company's*] internal control over financial reporting included controls over the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America and with the instructions to the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C).¹⁵ An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized

¹⁵ This sentence would be modified if the insured depository institution (IDI) reports at the institution level rather than at the bank holding company level to refer to the Federal Financial Institutions Examination Council Instructions for Consolidated Reports of Condition and Income instead of to the Form FR Y-9C. This sentence would also be modified if the IDI reports at a holding company level and employs another approach to reporting on controls over the preparation of regulatory reports as permitted by Section 36 of the FDI Act.

acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

[No proposed amendment to paragraphs 3–5.]

IDI Not Subject to Section 404 of Sarbanes-Oxley Act of 2002

6. The illustrative reports in exhibit A, "Illustrative Reports," of this section may be used to report on the effectiveness of the IDI's ICFR. Because 12 CFR Part 363 does not require the auditor to issue a separate auditor's report on the IDI's financial statements, the requirement in paragraph .65 of this section to add ~~an other matter~~ a paragraph to the ICFR report that references the financial statement audit will not apply when the auditor does not issue a separate auditor's report on the IDI's financial statements. In accordance with paragraph .64 of this section, the auditor's report on ICFR is required to include a definition of ICFR that uses the same description of ICFR as management uses in its report. The following is an illustrative definition paragraph that may be used when an IDI that is not subject to Section 404 of the Sarbanes-Oxley Act of 2002 is required to report on controls for FDICIA purposes at the IDI level, and the IDI uses the holding company's group financial statements to satisfy the audited financial statements requirement of 12 CFR Part 363:

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with generally accepted accounting principles. Because management's assessment and our audit were conducted to meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), our audit of [*IDI's*] internal control over financial reporting included controls over the preparation of financial information for purposes of [*consolidated holding company's*] financial statements in accordance with accounting principles generally accepted in the United States of America and controls over the preparation of schedules equivalent to basic financial statements in accordance with the Federal Financial Institutions Examination Council Instructions for Consolidated Reports of Condition and Income (Call Report Instructions). An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or

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

[No proposed amendment to paragraphs 7–8. No further amendment to AU-C section 940.]

5. The amendment is effective for audits of financial statements for periods ending on or after December 15, 2020. Early implementation is not permitted.

Appendix — Revised Illustrative Reports in AU-C Section 910, *Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country*

As mentioned in the Explanatory Memorandum of this exposure draft, there are no proposed amendments to the requirements or application material of AU-C section 910. The illustrative auditor’s reports in the exhibit to AU-C section 910 have been revised to conform with SAS No. 134 and included in this exposure draft for transparency.

Exhibit — Illustrations of Auditor’s Reports on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country

.A11

Illustration 1 — U.S. Form of Independent Auditor’s Report to Report on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country That Are Intended for Use Only Outside the United States

Illustration 2 — U.S. Form of Independent Auditor’s Report to Report on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country That Also Are Intended for Use in the United States

Illustration 1 — U.S. Form of Independent Auditor’s Report to Report on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country That Are Intended for Use Only Outside the United States

Independent Auditor’s Report

[Appropriate Addressee]

Opinion on the Financial Statements

We have audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders’ equity, and cash flows for the year then ended, and the related notes to the financial statements, which, as described in note X to the financial statements, have been prepared on the basis of [*specify the financial reporting framework generally accepted*] in [*name of country*].

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with [*specify the financial reporting framework generally accepted*] in [*name of country*].

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS) (and [*in name of country*]). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with [*specify the financial reporting framework generally accepted*] in [*name of country*], and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.^{fn 6}
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Illustration 2 — U.S. Form of Independent Auditor's Report to Report on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country That Also Are Intended for Use in the United States

[Appropriate Addressee]

Opinion on the Financial Statements

We have audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements, which, as described in note X to the financial statements, have been prepared on the basis of [*specify the financial reporting framework generally accepted*] in [*name of country*].

^{fn 6} In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with [*specify the financial reporting framework generally accepted*] in [*name of country*].

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS) (and [*in name of country*]). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter

As discussed in Note X to the financial statements, the Company prepares its financial statements in accordance with [*specify the financial reporting framework generally accepted*] in [*name of country*], which differ(s) from accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with [*specify the financial reporting framework generally accepted*] in [*name of country*], and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the

aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.^{fn 6}
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that we identified during the audit.

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

^{fn 6} In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."