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Codification of statements on standards for attestation engagements, as of January 2015, Numbers 1 to 17

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PREFACE

This publication, issued by the Accounting and Review Services Committee and the Auditing Standards Board (ASB), is a codification of Statements on Standards for Attestation Engagements (SSAEs), and the related attestation interpretations, applicable to the preparation and issuance of attestation reports for all nonissuers. Nonissuers are any entity not subject to the Sarbanes-Oxley Act of 2002 or the rules of the SEC.

SSAEs are issued by technical bodies of the AICPA designated to issue pronouncements on attestation matters. The "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct requires an AICPA member who performs an attest engagement (a practitioner) to comply with standards promulgated by such technical bodies. A practitioner is required to comply with an unconditional requirement in all cases in which the circumstances exist to which the unconditional requirement applies. A practitioner is also required to comply with a presumptively mandatory requirement in all cases in which the circumstances exist to which the presumptively mandatory requirement applies; however, in rare circumstances, the practitioner may depart from a presumptively mandatory requirement provided that the practitioner documents his or her justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the objectives of the presumptively mandatory requirement.

Attestation interpretations are recommendations on the application of SSAEs in specific circumstances, including engagements for entities in specialized industries, issued under the authority of AICPA technical bodies. An interpretation is not as authoritative as a standard; however, if a practitioner does not apply an attestation interpretation, the practitioner should be prepared to explain how he or she complied with the SSAE provisions addressed by such attestation interpretation. The specific terms used to define professional requirements in the SSAEs are not intended to apply to interpretations because interpretations are not attestation standards. It is the ASB's intention to make conforming changes to the interpretations over the next several years to remove any language that would imply a professional requirement where none exists.

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Audit and Attest Standards

AUDITING STANDARDS BOARD
Bruce P. Webb, Chair
Charles E. Landes, Vice President—
Professional Standards and Services

WHAT'S NEW IN THIS EDITION

Section	**Change**
AT Appendixes	Addition of appendixes to better reflect attestation-specific guidance.

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HOW THIS PUBLICATION IS ORGANIZED

The AT sections include attestation standards issued through Statement on Standards for Attestation Engagements (SSAE) No. 17, *Reporting on Compiled Prospective Financial Statements When the Practitioner's Independence Is Impaired*. Superseded portions have been deleted, and all applicable amendments have been included. These sections are arranged as follows:

AT Cross-References to SSAEs

Defining Professional Requirements in Statements on Standards for Attestation Engagements

SSAE Hierarchy

Attest Engagements

Agreed-Upon Procedures Engagements

Financial Forecasts and Projections

Reporting on Pro Forma Financial Information

An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements

Compliance Attestation

Management's Discussion and Analysis

Reporting on Controls at a Service Organization

Appendixes

Topical Index

The AT Cross-References to SSAEs is a list of all issued SSAEs and a list of sources of sections in the current text.

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

Attestation interpretations are numbered in the 9000 series with the last three digits indicating the section to which the interpretation relates. Interpretations immediately follow their corresponding section. For example, interpretations related to section 101 are numbered 9101, which directly follows section 101.

There are two appendixes relating to attestation standards as follows:

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

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

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

AT Section

STATEMENTS ON STANDARDS FOR ATTESTATION ENGAGEMENTS

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AT CROSS-REFERENCES TO SSAEs

Statements on Standards for Attestation Engagements*

No.	Date Issued	Title	Section
1	Mar. 1986	Attestation Standards [Revised and recodified by SSAE No. 10; see AT sections 101, 301, and 401]	
1	Dec. 1987	Attest Services Related to MAS Engagements [Revised and recodified by SSAE No. 10; see AT sections 101, 301, and 401]	
1	Oct. 1985	Financial Forecasts and Projections [Revised and recodified by SSAE No. 10; see AT sections 101, 301, and 401]	
1	Sept. 1988	Reporting on Pro Forma Financial Information [Revised and recodified by SSAE No. 10; see AT sections 101, 301, and 401]	
2	May 1993	Reporting on an Entity's Internal Control Over Financial Reporting [Revised and recodified by SSAE No. 10; subsequently superseded by SSAE No. 15, see AT section 501]	
3	Dec. 1993	Compliance Attestation [Revised and recodified by SSAE No. 10; see AT section 601]	
4	Sept. 1995	Agreed-Upon Procedures Engagements [Revised and recodified by SSAE No. 10; see AT section 201]	
5	Nov. 1995	Amendment to Statement on Standards for Attestation Engagements No. 1, *Attestation Standards* [Revised and recodified by SSAE No. 10; see AT section 101]	
6	Dec. 1995	Reporting on an Entity's Internal Control Over Financial Reporting: An Amendment to Statement on Standards for Attestation Engagements No. 2 [Revised and recodified by SSAE No. 10]	
7	Oct. 1997	Establishing an Understanding With the Client [Revised and recodified by SSAE No. 10; see AT section 101]	

(continued)

* Pronouncements in effect are indicated in **boldface** type.

No.	*Date Issued*	*Title*	*Section*
8	Mar. 1998	Management's Discussion and Analysis [Revised and recodified by SSAE No. 10; see AT section 701]	
9	Jan. 1999	Amendments to Statement on Standards for Attestation Engagements Nos. 1, 2, and 3 [Revised and recodified by SSAE No. 10; see AT sections 101 and 601]	
10	**Jan. 2001**	**Attestation Standards: Revision and Recodification**[1]	
11	**Jan. 2002**	**Attest Documentation**[2]	
12	**Sept. 2002**	**Amendment to Statement on Standards for Attestation Engagements No. 10, *Attestation Standards: Revision and Recodification*** [3]	
13	**Dec. 2005**	**Defining Professional Requirements in Statements on Standards for Attestation Engagements**	20
14	**Nov. 2006**	**SSAE Hierarchy**	50
15	**Sept. 2008**	**An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements**	501
16	**April 2010**	**Reporting on Controls at a Service Organization**	801
17	**Dec. 2010**	**Reporting on Compiled Prospective Financial Statements When the Practitioner's Independence Is Impaired** [4]	

[1] SSAE No. 10 has been integrated within AT sections 101, 201, 301, 401, 601, and 701.

[2] SSAE No. 11 has been integrated within AT sections 101.100–[.108], 201[.27–.30], 301[.17], and 301[.32].

[3] SSAE No. 12 has been integrated within AT sections 101.17–.18.

[4] SSAE No. 17 has been integrated within AT section 301.23.

Sources of Sections in Current Text

AT Section	*Contents*	*Source*
20	Defining Professional Requirements in Statements on Standards for Attestation Engagements	SSAE No. 13
50	SSAE Hierarchy	SSAE No. 14
101	Attest Engagements	SSAE No. 10
201	Agreed-Upon Procedures Engagements	SSAE No. 10
301	Financial Forecasts and Projections	SSAE No. 10
401	Reporting on Pro Forma Financial Information	SSAE No. 10
501	An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements	SSAE No. 15
601	Compliance Attestation	SSAE No. 10
701	Management's Discussion and Analysis	SSAE No. 10
801	Reporting on Controls at a Service Organization	SSAE No. 16

ATTESTATION STANDARDS

Introduction

The accompanying "attestation standards" provide guidance and establish a broad framework for a variety of attest services increasingly demanded of the accounting profession. The standards and related interpretive commentary are designed to provide professional guidelines that will enhance both consistency and quality in the performance of such services.

For years, attest services generally were limited to expressing a positive opinion on historical financial statements on the basis of an audit in accordance with generally accepted auditing standards (GAAS). However, certified public accountants increasingly have been requested to provide, and have been providing, assurance on representations other than historical financial statements and in forms other than the positive opinion. In responding to these needs, certified public accountants have been able to generally apply the basic concepts underlying GAAS to these attest services. As the range of attest services has grown, however, it has become increasingly difficult to do so.

Consequently, the main objective of adopting these attestation standards and the related interpretive commentary is to provide a general framework for and set reasonable boundaries around the attest function. As such, the standards and commentary (*a*) provide useful and necessary guidance to certified public accountants engaged to perform new and evolving attest services and (*b*) guide AICPA standard-setting bodies in establishing, if deemed necessary, interpretive standards for such services.

The attestation standards are a natural extension of the ten generally accepted auditing standards. Like the auditing standards, the attestation standards deal with the need for technical competence, independence in mental attitude, due professional care, adequate planning and supervision, sufficient evidence, and appropriate reporting; however, they are much broader in scope. (The eleven attestation standards are listed below.) Such standards apply to a growing array of attest services. These services include, for example, reports on descriptions of systems of internal control; on descriptions of computer software; on compliance with statutory, regulatory, and contractual requirements; on investment performance statistics; and on information supplementary to financial statements. Thus, the standards have been developed to be responsive to a changing environment and the demands of society.

These attestation standards apply only to attest services rendered by a certified public accountant in public practice—that is, a practitioner as defined in footnote 1 of paragraph .01.

The attestation standards do not supersede any of the existing standards in Statements on Auditing Standards (SASs) and Statements on Standards for Accounting and Review Services (SSARSs). Therefore, the practitioner who is engaged to perform an engagement subject to these existing standards should follow such standards.

Attestation Standards

General Standards

1. The practitioner must have adequate technical training and proficiency to perform in the attestation engagement.
2. The practitioner must have adequate knowledge of the subject matter.
3. The practitioner must have reason to believe that the subject matter is capable of evaluation against criteria that are suitable and available to users.
4. The practitioner must maintain independence in mental attitude in all matters relating to the engagement.
5. The practitioner must exercise due professional care in the planning and performance of the engagement and the preparation of the report.

Standards of Fieldwork

1. The practitioner must adequately plan the work and must properly supervise any assistants.
2. The practitioner must obtain sufficient evidence to provide a reasonable basis for the conclusion that is expressed in the report.

Standards of Reporting

1. The practitioner must identify the subject matter or the assertion being reported on and state the character of the engagement in the report.
2. The practitioner must state the practitioner's conclusion about the subject matter or the assertion in relation to the criteria against which the subject matter was evaluated.
3. The practitioner must state all of the practitioner's significant reservations about the engagement, the subject matter, and, if applicable, the assertion related thereto in the report.
4. The practitioner must state in the report that the report is intended solely for the information and use of the specified parties under the following circumstances:
    - When the criteria used to evaluate the subject matter are determined by the practitioner to be appropriate only for a limited number of parties who either participated in their establishment or can be presumed to have an adequate understanding of the criteria
    - When the criteria used to evaluate the subject matter are available only to specified parties
    - When reporting on subject matter and a written assertion has not been provided by the responsible party
    - When the report is on an attestation engagement to apply agreed-upon procedures to the subject matter

[As amended, effective for attest reports issued on or after June 30, 1999, by SSAE No. 9. As amended, effective when the subject matter or assertion is as of or for a period ending on or after June 1, 2001, by SSAE No. 10. Revised, December 2006, to reflect conforming changes necessary due to the issuance of SSAE No. 14. Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014]

Introduction

AT Section

STATEMENTS ON STANDARDS FOR ATTESTATION ENGAGEMENTS

The following is a Codification of currently effective Statements on Standards for Attestation Engagements ("SSAEs") and related Attestation Interpretations. Statements on Standards for Attestation Engagements are issued by senior committees of the AICPA designated to issue pronouncements on attestation matters. The "Compliance With Standards Rule" of the AICPA Code of Professional Conduct (ET sec. 1.310.001) requires an AICPA member who performs an attest engagement (a practitioner) to comply with such pronouncements. A practitioner is required to comply with an unconditional requirement in all cases in which the circumstances exist to which the unconditional requirement applies. A practitioner is also required to comply with a presumptively mandatory requirement in all cases in which the circumstances exist to which the presumptively mandatory requirement applies; however, in rare circumstances, the practitioner may depart from a presumptively mandatory requirement provided the practitioner documents his or her justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the objectives of the presumptively mandatory requirement.

Attestation Interpretations are recommendations on the application of SSAEs in specific circumstances, including engagements for entities in specialized industries, issued under the authority of AICPA senior committees. An interpretation is not as authoritative as a pronouncement; however, if a practitioner does not apply an attestation interpretation, the practitioner should be prepared to explain how he or she complied with the SSAE provisions addressed by such attestation interpretation. The specific terms used to define professional requirements in the SSAEs are not intended to apply to interpretations because interpretations are not attestation standards. It is the Auditing Standards Board's intention to make conforming changes to the interpretations over the next several years to remove any language that would imply a professional requirement where none exists.

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AT Section 20

Defining Professional Requirements in Statements on Standards for Attestation Engagements

Source: SSAE No. 13.

Effective December 2005.

Introduction

.01 This section sets forth the meaning of certain terms used in Statements on Standards for Attestation Engagements (SSAEs) issued by the Auditing Standards Board in describing the professional requirements imposed on practitioners.

Professional Requirements

.02 SSAEs contain professional requirements together with related guidance in the form of explanatory material. Practitioners have a responsibility to consider the entire text of an SSAE in carrying out their work on an engagement and in understanding and applying the professional requirements of the relevant SSAEs.

.03 Not every paragraph of an SSAE carries a professional requirement that the practitioner is expected to fulfill. Rather, the professional requirements are communicated by the language and the meaning of the words used in the SSAEs.

.04 SSAEs use two categories of professional requirements, identified by specific terms, to describe the degree of responsibility they impose on practitioners, as follows:

- *Unconditional requirements.* The practitioner is required to comply with an unconditional requirement in all cases in which the circumstances exist to which the unconditional requirement applies. SSAEs use the words *must* or *is required* to indicate an unconditional requirement.
- *Presumptively mandatory requirements.* The practitioner is also required to comply with a presumptively mandatory requirement in all cases in which the circumstances exist to which the presumptively mandatory requirement applies; however, in rare circumstances, the practitioner may depart from a presumptively mandatory requirement provided the practitioner documents his or her justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the objectives of the presumptively mandatory requirement. SSAEs use the word *should* to indicate a presumptively mandatory requirement.

If an SSAE provides that a procedure or action is one that the practitioner "should consider," the consideration of the procedure or action is presumptively required, whereas carrying out the procedure or action is not. The professional requirements of an SSAE are to be understood and applied in the context of the explanatory material that provides guidance for their application.

Explanatory Material

.05 Explanatory material is defined as the text within an SSAE (excluding any related appendixes or interpretations[1]) that may:

- Provide further explanation and guidance on the professional requirements; or
- Identify and describe other procedures or actions relating to the activities of the practitioner.

.06 Explanatory material that provides further explanation and guidance on the professional requirements is intended to be descriptive rather than imperative. That is, it explains the objective of the professional requirements (where not otherwise self-evident); it explains why the practitioner might consider or employ particular procedures, depending on the circumstances; and it provides additional information for the practitioner to consider in exercising professional judgment in performing the engagement.

.07 Explanatory material that identifies and describes other procedures or actions relating to the activities of the practitioner is not intended to impose a professional requirement for the practitioner to perform the suggested procedures or actions. Rather, these procedures or actions require the practitioner's attention and understanding; how and whether the practitioner carries out such procedures or actions in the engagement depends on the exercise of professional judgment in the circumstances consistent with the objective of the standard. The words *may*, *might*, and *could* are used to describe these actions and procedures.

Application

.08 The provisions of this section are effective upon issuance.[2]

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[1] Interpretive publications differ from explanatory material. Interpretive publications, for example, interpretations of the Statements on Standards for Attestation Engagements (SSAEs), appendixes to the SSAEs and AICPA auditing Statements of Position, are issued under the authority of the Auditing Standards Board (ASB). In contrast, explanatory material is always contained within the standards sections of the SSAE and is meant to be more descriptive in nature.

[2] The specific terms used to define professional requirements in this attestation standard are not intended to apply to any interpretive publications issued under the authority of the ASB, for example, interpretations of the SSAEs, or appendixes to the SSAEs, since interpretive publications are not attestation standards. (See footnote 1.) It is the ASB's intention to make conforming changes to the interpretive publications over the next several years to remove any language that would imply a professional requirement where none exists. It is the ASB's intention that such language would only be used in the standards sections of the SSAEs.

AT Section 50

SSAE Hierarchy

Source: SSAE No. 14.

Effective when the subject matter or assertion is as of or for a period ending on or after December 15, 2006.

.01 A practitioner plans, conducts, and reports the results of an attestation engagement in accordance with attestation standards. Attestation standards provide a measure of quality and the objectives to be achieved in the attestation engagement. Attestation procedures differ from attestation standards. Attestation procedures are acts that the practitioner performs during the course of the attestation engagement to comply with the attestation standards.

Attestation Standards

.02 The general, fieldwork, and reporting standards (the 11 attestation standards) approved and adopted by the membership of the AICPA, as amended by the AICPA Auditing Standards Board (ASB), are as follows:

General Standards

1. The practitioner must have adequate technical training and proficiency to perform the attestation engagement.
2. The practitioner must have adequate knowledge of the subject matter.
3. The practitioner must have reason to believe that the subject matter is capable of evaluation against criteria that are suitable and available to users.
4. The practitioner must maintain independence in mental attitude in all matters relating to the engagement.
5. The practitioner must exercise due professional care in the planning and performance of the engagement and the preparation of the report.

Standards of Fieldwork

1. The practitioner must adequately plan the work and must properly supervise any assistants.
2. The practitioner must obtain sufficient evidence to provide a reasonable basis for the conclusion that is expressed in the report.

Standards of Reporting[1]

1. The practitioner must identify the subject matter or the assertion being reported on and state the character of the engagement in the report.
2. The practitioner must state the practitioner's conclusion about the subject matter or the assertion in relation to the criteria against which the subject matter was evaluated in the report.
3. The practitioner must state all of the practitioner's significant reservations about the engagement, the subject matter, and, if applicable, the assertion related thereto in the report.

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[1] The reporting standards apply only when the practitioner issues a report.

4. The practitioner must state in the report that the report is intended solely for the information and use of the specified parties under the following circumstances:
   - When the criteria used to evaluate the subject matter are determined by the practitioner to be appropriate only for a limited number of parties who either participated in their establishment or can be presumed to have an adequate understanding of the criteria.
   - When the criteria used to evaluate the subject matter are available only to specified parties.
   - When reporting on subject matter and a written assertion has not been provided by the responsible party.
   - When the report is on an attestation engagement to apply agreed-upon procedures to the subject matter.

Footnote 1 is also to be added to the heading *Standards of Reporting* preceding paragraph .63 of section 101, *Attest Engagements*.

.03 Statements on Standards for Attestation Engagements (SSAEs) are issued by senior committees of the AICPA designated to issue pronouncements on attestation matters. The "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct requires an AICPA member who performs an attestation engagement (the practitioner) to comply with such pronouncements.[2] SSAEs are developed and issued through a due process that includes deliberation in meetings open to the public, public exposure of proposed SSAEs, and a formal vote. The SSAEs are codified within the framework of the 11 attestation standards. [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

.04 The nature of the 11 attestation standards and the SSAEs requires the practitioner to exercise professional judgment in applying them. When, in rare circumstances, the practitioner departs from a presumptively mandatory requirement, the practitioner must document in the working papers his or her justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the objectives of the presumptively mandatory requirement.[3]

Attestation Interpretations[4]

.05 Attestation interpretations consist of Interpretations of the SSAEs, appendixes to the SSAEs, attestation guidance included in AICPA Audit and Accounting Guides, and AICPA attestation Statements of Position. Attestation interpretations are recommendations on the application of SSAEs in specific circumstances, including engagements for entities in specialized industries, issued under the authority of the AICPA senior committees.

.06 The practitioner should be aware of and consider attestation interpretations applicable to the attestation engagement. If the practitioner does not

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[2] In certain engagements, the practitioner also may be subject to other attestation requirements, such as *Government Auditing Standards* issued by the comptroller general of the United States.

[3] The term *presumptively mandatory requirement* is defined in section 20, *Defining Professional Requirements in Statements on Standards for Attestation Engagements*.

[4] Appendixes to Statements on Standards for Attestation Engagements (SSAEs) referred to in paragraph .05 of this section do not include previously issued appendixes to original pronouncements that, when adopted, modified other SSAEs.

apply the attestation guidance included in an applicable attestation interpretation, the practitioner should be prepared to explain how he or she complied with the SSAE provisions addressed by such attestation guidance.

Other Attestation Publications

.07 Other attestation publications include AICPA attestation publications not referred to above; attestation articles in the *Journal of Accountancy* and other professional journals; attestation articles in the AICPA *CPA Letter*; continuing professional education programs and other instruction materials, textbooks, guide books, attest programs, and checklists; and other attestation publications from state CPA societies, other organizations, and individuals.[5] Other attestation publications have no authoritative status; however, they may help the practitioner understand and apply the SSAEs.

.08 A practitioner may apply the attestation guidance included in an other attestation publication if he or she is satisfied that, in his or her judgment, it is both relevant to the circumstances of the attestation engagement, and appropriate. In determining whether an other attestation publication is appropriate, the practitioner may wish to consider the degree to which the publication is recognized as being helpful in understanding and applying SSAEs and the degree to which the issuer or author is recognized as an authority in attestation matters. Other attestation publications published by the AICPA that have been reviewed by the AICPA Audit and Attest Standards Staff are presumed to be appropriate.

.09 This section is effective when the subject matter or assertion is as of or for a period ending on or after December 15, 2006.

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[5] The practitioner is not expected to be aware of the full body of other attestation publications.

AT Section 101

Attest Engagements

Source: SSAE No. 10; SSAE No. 11; SSAE No. 12; SSAE No. 14.

See section 9101 for interpretations of this section.

Effective when the subject matter or assertion is as of or for a period ending on or after June 1, 2001, unless otherwise indicated.

Applicability

.01 This section applies to engagements, except for those services discussed in paragraph .04, in which a certified public accountant in public practice[1] (hereinafter referred to as a *practitioner*) is engaged to issue or does issue an examination, a review, or an agreed-upon procedures report on subject matter, or an assertion about the subject matter (hereafter referred to as *the assertion*), that is the responsibility of another party.[2] [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

.02 This section establishes a framework for attest[3] engagements performed by practitioners and for the ongoing development of related standards. For certain subject matter, specific attestation standards have been developed to provide additional requirements for engagement performance and reporting.

.03 When a practitioner undertakes an attest engagement for the benefit of a government body or agency and agrees to follow specified government standards, guides, procedures, statutes, rules, and regulations, the practitioner is obliged to follow those governmental requirements as well as the applicable attestation standards.

.04 Professional services provided by practitioners that are not covered by this SSAE include the following:

a. Services performed in accordance with Statements on Auditing Standards (SASs)

b. Services performed in accordance with Statements on Standards for Accounting and Review Services (SSARSs)

c. Services performed in accordance with the Statement on Standards for Consulting Services (SSCS), such as engagements in which the practitioner's role is solely to assist the client (for example, acting as the company accountant in preparing information other than financial

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[1] For a definition of the term *public practice*, see ET section 0.400, *Definitions*. [Footnote revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

[2] See paragraph .02 of section 301, *Financial Forecasts and Projections*, for additional guidance on applicability when engaged to provide an attest service on a financial forecast or projection.

[3] The term *attest* and its variants, such as *attesting* and *attestation,* are used in a number of state accountancy laws, and in regulations issued by state boards of accountancy under such laws, for different purposes and with different meanings from those intended by this section. Consequently, the definition of *attest engagements* set out in paragraph .01, and the attendant meaning of *attest* and *attestation* as used throughout the section, should not be understood as defining these terms and similar terms, as they are used in any law or regulation, nor as embodying a common understanding of the terms which may also be reflected in such laws or regulations.

statements), or engagements in which a practitioner is engaged to testify as an expert witness in accounting, auditing, taxation, or other matters, given certain stipulated facts

d. Engagements in which the practitioner is engaged to advocate a client's position—for example, tax matters being reviewed by the Internal Revenue Service

e. Tax engagements in which a practitioner is engaged to prepare tax returns or provide tax advice

.05 An attest engagement may be part of a larger engagement, for example, a feasibility study or business acquisition study may also include an examination of prospective financial information. In such circumstances, these standards apply only to the attest portion of the engagement.

.06 Any professional service resulting in the expression of assurance must be performed under AICPA professional standards that provide for the expression of such assurance. Reports issued by a practitioner in connection with other professional standards should be written to be clearly distinguishable from and not to be confused with attest reports. For example, a practitioner performing an engagement which is intended solely to assist an organization in improving its controls over the privacy of client data should not issue a report as a result of that engagement expressing assurance as to the effectiveness of such controls. Additionally, a report that merely excludes the words, " ...was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants..." but is otherwise similar to an examination, a review or an agreed-upon procedures attest report may be inferred to be an attest report.

Definitions and Underlying Concepts

Subject Matter

.07 The subject matter of an attest engagement may take many forms, including the following:

a. Historical or prospective performance or condition (for example, historical or prospective financial information, performance measurements, and backlog data)

b. Physical characteristics (for example, narrative descriptions, square footage of facilities)

c. Historical events (for example, the price of a market basket of goods on a certain date)

d. Analyses (for example, break-even analyses)

e. Systems and processes (for example, internal control)

f. Behavior (for example, corporate governance, compliance with laws and regulations, and human resource practices)

The subject matter may be as of a point in time or for a period of time.

Assertion

.08 An assertion is any declaration or set of declarations about whether the subject matter is based on or in conformity with the criteria selected.

.09 A practitioner may report on a written assertion or may report directly on the subject matter. In either case, the practitioner should ordinarily obtain a written assertion in an examination or a review engagement. A written assertion may be presented to a practitioner in a number of ways, such as in a narrative description, within a schedule, or as part of a representation letter appropriately identifying what is being presented and the point in time or period of time covered.

.10 When a written assertion has not been obtained, a practitioner may still report on the subject matter; however, the form of the report will vary depending on the circumstances and its use should be restricted.[4] In this section, see paragraphs .58 and .60 on gathering sufficient evidence and paragraphs .73–.75 and .78–.80 for reporting guidance.

Responsible Party

.11 The *responsible party* is defined as the person or persons, either as individuals or representatives of the entity, responsible for the subject matter. If the nature of the subject matter is such that no such party exists, a party who has a reasonable basis for making a written assertion about the subject matter may provide such an assertion (hereinafter referred to as the *responsible party*).

.12 The practitioner may be engaged to gather information to enable the responsible party to evaluate the subject matter in connection with providing a written assertion. Regardless of the procedures performed by the practitioner, the responsible party must accept responsibility for its assertion and the subject matter and must not base its assertion solely on the practitioner's procedures.[5]

.13 Because the practitioner's role in an attest engagement is that of an *attester*, the practitioner should not take on the role of the responsible party in an attest engagement. Therefore, the need to clearly identify a responsible party is a prerequisite for an attest engagement. A practitioner may accept an engagement to perform an examination, a review or an agreed-upon procedures engagement on subject matter or an assertion related thereto provided that one of the following conditions is met.

a. The party wishing to engage the practitioner is responsible for the subject matter, or has a reasonable basis for providing a written assertion about the subject matter if the nature of the subject matter is such that a responsible party does not otherwise exist.

b. The party wishing to engage the practitioner is not responsible for the subject matter but is able to provide the practitioner, or have a third party who is responsible for the subject matter provide the practitioner, with evidence of the third party's responsibility for the subject matter.

.14 The practitioner should obtain written acknowledgment or other evidence of the responsible party's responsibility for the subject matter, or the written assertion, as it relates to the objective of the engagement. The responsible party can acknowledge that responsibility in a number of ways, for example, in an engagement letter, a representation letter, or the presentation of the subject matter, including the notes thereto, or the written assertion. If the practitioner is not able to directly obtain written acknowledgment, the practitioner should obtain other evidence of the responsible party's responsibility for the subject matter (for example, by reference to legislation, a regulation, or a contract).

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[4] When the practitioner is unable to perform the inquiry and analytical or other procedures that he or she considers necessary to achieve the limited assurance contemplated by a review, or when the client is the responsible party and does not provide the practitioner with a written assertion, the review will be incomplete. A review that is incomplete is not an adequate basis for issuing a review report and, accordingly, the practitioner should withdraw from the engagement.

[5] See paragraph .112 regarding the practitioner's assistance in developing subject matter or criteria.

Applicability to Agreed-Upon Procedures Engagements

.15 An agreed-upon procedures attest engagement is one in which a practitioner is engaged to issue a report of findings based on specific procedures performed on subject matter. The general, fieldwork, and reporting standards for attest engagements set forth in this section are applicable to agreed-upon procedures engagements. Because the application of these standards to agreed-upon procedures engagements is discussed in section 201, *Agreed-Upon Procedures Engagements*, such engagements are not discussed further in this section.

The Relationship of Attestation Standards to Quality Control Standards

.16 The practitioner is responsible for compliance with the American Institute of Certified Public Accountants' (AICPA's) Statements on Standards for Attestation Engagements (SSAEs) in an attest engagement. The "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA Code of Professional Conduct requires members to comply with such standards when conducting professional services. [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

.17 A firm of practitioners has a responsibility to adopt a system of quality control in the conduct of a firm's attest practice.[6] Thus, a firm should establish quality control policies and procedures to provide it with reasonable assurance that its personnel comply with the attestation standards in its attest engagements. The nature and extent of a firm's quality control policies and procedures depend on factors such as its size, the degree of operating autonomy allowed its personnel and its practice offices, the nature of its practice, its organization, and appropriate cost-benefit considerations. [As amended, effective September 2002, by SSAE No. 12.]

.18 Attestation standards relate to the conduct of individual attest engagements; quality control standards relate to the conduct of a firm's attest practice as a whole. Thus, attestation standards and quality control standards are related and the quality control policies and procedures that a firm adopts may affect both the conduct of individual attest engagements and the conduct of a firm's attest practice as a whole. However, deficiencies in or instances of noncompliance with a firm's quality control policies and procedures do not, in and of themselves, indicate that a particular engagement was not performed in accordance with attestation standards. [As amended, effective September 2002, by SSAE No. 12.]

General Standards

Training and Proficiency

.19 The first general standard is—*The practitioner must have adequate technical training and proficiency to perform the attestation engagement.* [As

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[6] The elements of a system of quality control are identified in Statement on Quality Control Standards (SQCS) No. 8, *A Firm's System of Quality Control* (QC sec. 10). A system of quality control consists of policies designed to provide the firm with reasonable assurance that the firm and its personnel comply with professional standards and applicable legal and regulatory requirements and that reports issued by the firm are appropriate in the circumstances, and the procedures necessary to implement and monitor compliance with those policies. [As amended, effective September 2002, by SSAE No. 12. Footnote amended due to the issuance of SQCS No. 7, December 2008.]

amended, effective when the subject matter or assertion is as of or for a period ending on or after December 15, 2006, by SSAE No. 14.]

.20 Performing attest services is different from preparing and presenting subject matter or an assertion. The latter involves collecting, classifying, summarizing, and communicating information; this usually entails reducing a mass of detailed data to a manageable and understandable form. On the other hand, performing attest services involves gathering evidence to support the subject matter or the assertion and objectively assessing the measurements and communications of the responsible party. Thus, attest services are analytical, critical, investigative, and are concerned with the basis and support for the subject matter or the assertion.

Adequate Knowledge of Subject Matter

.21 The second general standard is—*The practitioner must have adequate knowledge of the subject matter.* [As amended, effective when the subject matter or assertion is as of or for a period ending on or after December 15, 2006, by SSAE No. 14.]

.22 A practitioner may obtain adequate knowledge of the subject matter through formal or continuing education, including self-study, or through practical experience. However, this standard does not necessarily require a practitioner to personally acquire all of the necessary knowledge in the subject matter to be qualified to express a conclusion. This knowledge requirement may be met, in part, through the use of one or more specialists on a particular attest engagement if the practitioner has sufficient knowledge of the subject matter (*a*) to communicate to the specialist the objectives of the work and (*b*) to evaluate the specialist's work to determine if the objectives were achieved.

Suitability and Availability of Criteria

.23 The third general standard is—*The practitioner must have reason to believe that the subject matter is capable of evaluation against criteria that are suitable and available to users.* [As amended, effective when the subject matter or assertion is as of or for a period ending on or after December 15, 2006, by SSAE No. 14.]

Suitability of Criteria

.24 Criteria are the standards or benchmarks used to measure and present the subject matter and against which the practitioner evaluates the subject matter.[*] Suitable criteria must have each of the following attributes:

- *Objectivity*—Criteria should be free from bias.
- *Measurability*—Criteria should permit reasonably consistent measurements, qualitative or quantitative, of subject matter.
- *Completeness*—Criteria should be sufficiently complete so that those relevant factors that would alter a conclusion about subject matter are not omitted.
- *Relevance*—Criteria should be relevant to the subject matter.

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[*] An example of suitable criteria are the Trust Services criteria developed by the AICPA's Assurance Services Executive Committee. These criteria may be used when the subject matter of the engagement is the security, availability, or processing integrity of a system, or the confidentiality or privacy of the information processed or stored by that system. The Trust Services criteria are presented in TSP sections 100 and 200 of the AICPA's *Trust Services Principles and Criteria*. [Footnote added by the Assurance Services Executive Committee, January 2003. Footnote revised, May 2006, to reflect conforming changes necessary due to the issuance of Generally Accepted Privacy Principles.]

.25 Criteria that are established or developed by groups composed of experts that follow due process procedures, including exposure of the proposed criteria for public comment, ordinarily should be considered suitable. Criteria promulgated by a body designated by the AICPA Governing Council under the AICPA Code of Professional Conduct are, by definition, considered to be suitable.

.26 Criteria may be established or developed by the client, the responsible party, industry associations, or other groups that do not follow due process procedures or do not as clearly represent. the public interest. To determine whether these criteria are suitable, the practitioner should evaluate them based on the attributes described in paragraph .24.

.27 Regardless of who establishes or develops the criteria, the responsible party or the client is responsible for selecting the criteria and the client is responsible for determining that such criteria are appropriate for its purposes.

.28 The use of suitable criteria does not presume that all persons or groups would be expected to select the same criteria in evaluating the same subject matter. There may be more than one set of suitable criteria for a given subject matter. For example, in an engagement to express assurance about customer satisfaction, a responsible party may select as a criterion for customer satisfaction that all customer complaints are resolved to the satisfaction of the customer. In other cases, another responsible party may select a different criterion, such as the number of repeat purchases in the three months following the initial purchase.

.29 In evaluating the measurability attribute as described in paragraph .24, the practitioner should consider whether the criteria are sufficiently precise to permit people having competence in and using the same measurement criterion to be able to ordinarily obtain materially similar measurements. Consequently, practitioners should not perform an engagement when the criteria are so subjective or vague that reasonably consistent measurements, qualitative or quantitative, of subject matter cannot ordinarily be obtained. However, practitioners will not always reach the same conclusion because such evaluations often require the exercise of considerable professional judgment.

.30 For the purpose of assessing whether the use of particular criteria can be expected to yield reasonably consistent measurement and evaluation, consideration should be given to the nature of the subject matter. For example, *soft information*, such as forecasts or projections, would be expected to have a wider range of reasonable estimates than *hard* data, such as the calculated investment performance of a defined portfolio of managed investment products.

.31 Some criteria may be appropriate for only a limited number of parties who either participated in their establishment or can be presumed to have an adequate understanding of the criteria. For instance, criteria set forth in a lease agreement for override payments may be appropriate only for reporting to the parties to the agreement because of the likelihood that such criteria would be misunderstood or misinterpreted by parties other than those who have specifically agreed to the criteria. Such criteria can be agreed upon directly by the parties or through a designated representative. If a practitioner determines that such criteria are appropriate only for a limited number of parties, the use of the report should be restricted to those specified parties who either participated in their establishment or can be presumed to have an adequate understanding of the criteria.

.32 The third general standard in paragraph .23 applies equally regardless of the level of the attest service to be provided. Consequently, it is inappropriate to perform a review engagement if the practitioner concludes that an examination cannot be performed because competent persons using the same criteria would not be able to obtain materially similar evaluations.

Availability of Criteria

.33 The criteria should be available to users in one or more of the following ways:

a. Available publicly

b. Available to all users through inclusion in a clear manner in the presentation of the subject matter or in the assertion

c. Available to all users through inclusion in a clear manner in the practitioner's report

d. Well understood by most users, although not formally available (for example, "The distance between points A and B is twenty feet;" the criterion of distance measured in feet is considered to be well understood)

e. Available only to specified parties; for example, terms of a contract or criteria issued by an industry association that are available only to those in the industry

.34 If criteria are only available to specified parties, the practitioner's report should be restricted to those parties who have access to the criteria as described in paragraphs .78 and .80.

Independence

.35 The fourth general standard is—*The practitioner must maintain independence in mental attitude in all matters relating to the engagement.*[7] [As amended, effective when the subject matter or assertion is as of or for a period ending on or after December 15, 2006, by SSAE No. 14.]

.36 The practitioner should maintain the intellectual honesty and impartiality necessary to reach an unbiased conclusion about the subject matter or the assertion. This is a cornerstone of the attest function.

.37 In the final analysis, independence in mental attitude means objective consideration of facts, unbiased judgments, and honest neutrality on the part of the practitioner in forming and expressing conclusions. It implies not the attitude of an advocate or an adversary but an impartiality that recognizes an obligation for fairness. Independence in mental attitude presumes an undeviating concern for an unbiased conclusion about the subject matter or an assertion no matter what the subject matter or the assertion may be.

.38 The profession has established, through the AICPA's Code of Professional Conduct, precepts to guard against the *presumption* of loss of independence. Presumption is stressed because the possession of intrinsic independence is a matter of personal quality rather than of rules that formulate certain objective tests. Insofar as these precepts have been incorporated in the

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[7] The practitioner performing an attest engagement should be independent pursuant to "Independence Rule" (ET sec. 1.200.001) of the AICPA Code of Professional Conduct. The "Independence Standards for Engagements Performed in Accordance With Statements on Standards for Attestation Engagements" subtopic (ET sec. 1.297) provides guidance about its application to certain attest engagements. [Footnote revised, December 2012, to reflect conforming changes necessary due to the revision of Ethics Interpretation 101-11. Footnote revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

profession's code, they have the force of professional law for the independent practitioner.

Due Professional Care

.39 The fifth general standard is—*The practitioner must exercise due professional care in the planning and performance of the engagement and the preparation of the report.* [As amended, effective when the subject matter or assertion is as of or for a period ending on or after December 15, 2006, by SSAE No. 14.]

.40 Due professional care imposes a responsibility on each practitioner involved with the engagement to observe each of the attestation standards. Exercise of due professional care requires critical review at every level of supervision of the work done and the judgment exercised by those assisting in the engagement, including the preparation of the report.

.41 *Cooley on Torts*, a legal treatise, describes the obligation for due care as follows:

> Every man who offers his services to another and is employed assumes the duty to exercise in the employment such skill as he possesses with reasonable care and diligence. In all these employments where peculiar skill is requisite, if one offers his services, he is understood as holding himself out to the public as possessing the degree of skill commonly possessed by others in the same employment, and if his pretentions are unfounded, he commits a species of fraud upon every man who employs him in reliance on his public profession. But no man, whether skilled or unskilled, undertakes that the task he assumes shall be performed successfully, and without fault or error; he undertakes for good faith and integrity, but not for infallibility, and he is liable to his employer for negligence, bad faith, or dishonesty, but not for losses consequent upon mere errors of judgment.[8]

Standards of Fieldwork

Planning and Supervision

.42 The first standard of fieldwork is—*The practitioner must adequately plan the work and must properly supervise any assistants.* [As amended, effective when the subject matter or assertion is as of or for a period ending on or after December 15, 2006, by SSAE No. 14.]

.43 Proper planning and supervision contribute to the effectiveness of attest procedures. Proper planning directly influences the selection of appropriate procedures and the timeliness of their application, and proper supervision helps ensure that planned procedures are appropriately applied.

.44 Planning an attest engagement involves developing an overall strategy for the expected conduct and scope of the engagement. To develop such a strategy, practitioners need to have sufficient knowledge to enable them to understand adequately the events, transactions, and practices that, in their judgment, have a significant effect on the subject matter or the assertion.

.45 Factors to be considered by the practitioner in planning an attest engagement include the following:

a. The criteria to be used

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[8] D. Haggard, *Cooley on Torts*, 472 (4th ed., 1932).

b. Preliminary judgments about attestation risk[9] and materiality for attest purposes

c. The nature of the subject matter or the items within the assertion that are likely to require revision or adjustment

d. Conditions that may require extension or modification of attest procedures

e. The nature of the report expected to be issued

.46 The practitioner should establish an understanding with the client regarding the services to be performed for each engagement.[10] Such an understanding reduces the risk that either the practitioner or the client may misinterpret the needs or expectations of the other party. For example, it reduces the risk that the client may inappropriately rely on the practitioner to protect the entity against certain risks or to perform certain functions that are the client's responsibility. The understanding should include the objectives of the engagement, management's responsibilities, the practitioner's responsibilities, and limitations of the engagement. The practitioner should document the understanding in the working papers, preferably through a written communication with the client. If the practitioner believes an understanding with the client has not been established, he or she should decline to accept or perform the engagement.

.47 The nature, extent, and timing of planning will vary with the nature and complexity of the subject matter or the assertion and the practitioner's prior experience with management. As part of the planning process, the practitioner should consider the nature, extent, and timing of the work to be performed to accomplish the objectives of the attest engagement. Nevertheless, as the attest engagement progresses, changed conditions may make it necessary to modify planned procedures.

.48 Supervision involves directing the efforts of assistants who participate in accomplishing the objectives of the attest engagement and determining whether those objectives were accomplished. Elements of supervision include instructing assistants, staying informed of significant problems encountered, reviewing the work performed, and dealing with differences of opinion among personnel. The extent of supervision appropriate in a given instance depends on many factors, including the nature and complexity of the subject matter and the qualifications of the persons performing the work.

.49 Assistants should be informed of their responsibilities, including the objectives of the procedures that they are to perform and matters that may affect the nature, extent, and timing of such procedures. The practitioner with final responsibility for the engagement should direct assistants to bring to his or her attention significant questions raised during the attest engagement so that their significance may be assessed.

.50 The work performed by each assistant should be reviewed to determine whether it was adequately performed and to evaluate whether the results are consistent with the conclusion to be presented in the practitioner's report.

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[9] *Attestation risk* is the risk that the practitioner may unknowingly fail to appropriately modify his or her attest report on the subject matter or an assertion that is materially misstated. It consists of (*a*) the risk (consisting of *inherent risk* and *control risk*) that the subject matter or assertion contains deviations or misstatements that could be material and (*b*) the risk that the practitioner will not detect such deviations or misstatements (*detection risk*).

[10] See paragraph 29 of SQCS No. 8. [Footnote amended due to the issuance of SQCS No. 7, December 2008. Footnote revised, December 2012, due to the issuance of SQCS No. 8.]

Obtaining Sufficient Evidence

.51 The second standard of fieldwork is—*The practitioner must obtain sufficient evidence to provide a reasonable basis for the conclusion that is expressed in the report.* [As amended, effective when the subject matter or assertion is as of or for a period ending on or after December 15, 2006, by SSAE No. 14.]

.52 Selecting and applying procedures that will accumulate evidence that is sufficient in the circumstances to provide a reasonable basis for the level of assurance to be expressed in the attest report requires the careful exercise of professional judgment. A broad array of available procedures may be applied in an attest engagement. In establishing a proper combination of procedures to appropriately restrict attestation risk, the practitioner should consider the following presumptions, bearing in mind that they are not mutually exclusive and may be subject to important exceptions.

a. Evidence obtained from independent sources outside an entity provides greater assurance about the subject matter or the assertion than evidence secured solely from within the entity.

b. Information obtained from the independent attester's direct personal knowledge (such as through physical examination, observation, computation, operating tests, or inspection) is more persuasive than information obtained indirectly.

c. The more effective the controls over the subject matter, the more assurance they provide about the subject matter or the assertion.

.53 Thus, in the hierarchy of available attest procedures, those that involve search and verification (for example, inspection, confirmation, or observation), particularly when using independent sources outside the entity, are generally more effective in restricting attestation risk than those involving internal inquiries and comparisons of internal information (for example, analytical procedures and discussions with individuals responsible for the subject matter or the assertion). On the other hand, the latter are generally less costly to apply.

.54 In an attest engagement designed to provide a high level of assurance (referred to as an *examination*), the practitioner's objective is to accumulate sufficient evidence to restrict attestation risk to a level that is, in the practitioner's professional judgment, appropriately low for the high level of assurance that may be imparted by his or her report. In such an engagement, a practitioner should select from all available procedures—that is, procedures that assess inherent and control risk and restrict detection risk—any combination that can restrict attestation risk to such an appropriately low level.

.55 In an attest engagement designed to provide a moderate level of assurance (referred to as a *review*), the objective is to accumulate sufficient evidence to restrict attestation risk to a moderate level. To accomplish this, the types of procedures performed generally are limited to inquiries and analytical procedures (rather than also including search and verification procedures).

.56 Nevertheless, there will be circumstances in which inquiry and analytical procedures (*a*) cannot be performed, (*b*) are deemed less efficient than other procedures, or (*c*) yield evidence indicating that the subject matter or the assertion may be incomplete or inaccurate. In the first circumstance, the practitioner should perform other procedures that he or she believes can provide him or her with a level of assurance equivalent to that which inquiries and analytical procedures would have provided. In the second circumstance, the practitioner may perform other procedures that he or she believes would be more efficient to provide him or her with a level of assurance equivalent to that which inquiries and analytical procedures would provide. In the third circumstance, the practitioner should perform additional procedures.

.57 The extent to which attestation procedures will be performed should be based on the level of assurance to be provided and the practitioner's consideration of (*a*) the nature and materiality of the information to be tested to the subject matter or the assertion taken as a whole, (*b*) the likelihood of misstatements, (*c*) knowledge obtained during current and previous engagements, (*d*) the responsible party's competence in the subject matter, (*e*) the extent to which the information is affected by the asserter's judgment, and (*f*) inadequacies in the responsible party's underlying data.

.58 As part of the attestation procedures, the practitioner considers the written assertion ordinarily provided by the responsible party. If a written assertion cannot be obtained from the responsible party, the practitioner should consider the effects on his or her ability to obtain sufficient evidence to form a conclusion about the subject matter. When the practitioner's client is the responsible party, a failure to obtain a written assertion should result in the practitioner concluding that a scope limitation exists.[11] When the practitioner's client is not the responsible party and a written assertion is not provided, the practitioner may be able to conclude that he or she has sufficient evidence to form a conclusion about the subject matter.

Representation Letter

.59 During an attest engagement, the responsible party makes many representations to the practitioner, both oral and written, in response to specific inquiries or through the presentation of subject matter or an assertion. Such representations from the responsible party are part of the evidential matter the practitioner obtains.

.60 Written representations from the responsible party ordinarily confirm representations explicitly or implicitly given to the practitioner, indicate and document the continuing appropriateness of such representations, and reduce the possibility of misunderstanding concerning the matters that are the subject of the representations. Accordingly, in an examination or a review engagement, a practitioner should consider obtaining a representation letter from the responsible party. Examples of matters that might appear in such a representation letter include the following:[12]

a. A statement acknowledging responsibility for the subject matter and, when applicable, the assertion

b. A statement acknowledging responsibility for selecting the criteria, where applicable

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[11] When the client is the responsible party, it is presumed that the client will be capable of providing the practitioner with a written assertion regarding the subject matter. Failure to provide the written assertion in this circumstance is a client-imposed limitation on the practitioner's evidence-gathering efforts. In an examination, the practitioner should modify the report for the scope limitation. In a review engagement, such a scope limitation results in an incomplete review and the practitioner should withdraw from the engagement.

[12] Specific written representations will depend on the circumstances of the engagement (for example, whether the client is the responsible party) and the nature of the subject matter and the criteria. For example, when the client is not the responsible party but has selected the criteria, the practitioner might obtain the representation regarding responsibility for selection of the criteria from the client rather than the responsible party (see paragraph .61).

c. A statement acknowledging responsibility for determining that such criteria are appropriate for its purposes, where the responsible party is the client

d. The assertion about the subject matter based on the criteria selected

e. A statement that all known matters contradicting the assertion and any communication from regulatory agencies affecting the subject matter or the assertion have been disclosed to the practitioner

f. Availability of all records relevant to the subject matter

g. A statement that any known events subsequent to the period (or point in time) of the subject matter being reported on that would have a material effect on the subject matter (or, if applicable, the assertion) have been disclosed to the practitioner

h. Other matters as the practitioner deems appropriate

.61 When the client is not the responsible party, the practitioner should consider obtaining a letter of written representations from the client as part of the attest engagement. Examples of matters that might appear in such a representation letter include the following:

a. A statement that any known events subsequent to the period (or point in time) of the subject matter being reported on that would have a material effect on the subject matter (or, if applicable, the assertion) have been disclosed to the practitioner

b. A statement acknowledging the client's responsibility for selecting the criteria, where applicable

c. A statement acknowledging the client's responsibility for determining that such criteria are appropriate for its purposes

d. Other matters as the practitioner deems appropriate

.62 If the responsible party or the client refuses to furnish all written representations that the practitioner deems necessary, the practitioner should consider the effects of such a refusal on his or her ability to issue a conclusion about the subject matter. If the practitioner believes that the representation letter is necessary to obtain sufficient evidence to issue a report, the responsible party's or the client's refusal to furnish such evidence in the form of written representations constitutes a limitation on the scope of an examination sufficient to preclude an unqualified opinion and is ordinarily sufficient to cause the practitioner to disclaim an opinion or withdraw from an examination engagement. However, based on the nature of the representations not obtained or the circumstances of the refusal, the practitioner may conclude, in an examination engagement, that a qualified opinion is appropriate. Further, the practitioner should consider the effects of the refusal on his or her ability to rely on other representations. When a scope limitation exists in a review engagement, the practitioner should withdraw from the engagement. (See paragraph .75.)

Standards of Reporting[13]

.63 The first standard of reporting is—*The practitioner must identify the subject matter or the assertion being reported on and state the character of the engagement in the report.* [As amended, effective when the subject matter or assertion is as of or for a period ending on or after December 15, 2006, by SSAE No. 14.]

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[13] The reporting standards apply only when the practitioner issues a report. [Footnote added, effective when the subject matter or assertion is as of or for a period ending on or after December 15, 2006, by SSAE No. 14.]

.64 The practitioner who accepts an attest engagement should issue a report on the subject matter or the assertion or withdraw from the attest engagement. If the practitioner is reporting on the assertion, the assertion should be bound with or accompany the practitioner's report or the assertion should be clearly stated in the practitioner's report.[14]

.65 The statement of the character of an attest engagement includes the following two elements: (*a*) a description of the nature and scope of the work performed and (*b*) a reference to the professional standards governing the engagement. The terms *examination* and *review* should be used to describe engagements to provide, respectively, a high level and a moderate level of assurance. The reference to professional standards should be accomplished by referring to "attestation standards established by the American Institute of Certified Public Accountants."

.66 The second standard of reporting is—*The practitioner must state the practitioner's conclusion about the subject matter or the assertion in relation to the criteria against which the subject matter was evaluated in the report.* However, if conditions exist that, individually or in combination, result in one or more material misstatements or deviations from the criteria, the practitioner should modify the report and, to most effectively communicate with the reader of the report, should ordinarily express his or her conclusion directly on the subject matter,[15] not on the assertion. [As amended, effective when the subject matter or assertion is as of or for a period ending on or after December 15, 2006, by SSAE No. 14.]

.67 The practitioner should consider the concept of materiality in applying this standard. In expressing a conclusion, the practitioner should consider an omission or a misstatement to be material if the omission or misstatement—individually or when aggregated with others—is such that a reasonable person would be influenced by the omission or misstatement. The practitioner should consider both qualitative and quantitative aspects of omissions and misstatements.

.68 The term *general use* applies to attest reports that are not restricted to specified parties. General-use attest reports should be limited to two levels of assurance: one based on a restriction of attestation risk to an appropriately low level (an *examination*) and the other based on a restriction of attestation risk to a moderate level (a *review*). In an engagement to achieve a high level of assurance (an *examination*), the practitioner's conclusion should be expressed in the form of an opinion. When attestation risk has been restricted only to a moderate level (a *review*), the conclusion should be expressed in the form of negative assurance.

.69 A practitioner may report on subject matter or an assertion at multiple dates or covering multiple periods during which criteria have changed (for example, a report on comparative information). In those circumstances, the practitioner should determine whether the criteria are clearly stated or described for each of the dates or periods, and whether the changes have been adequately disclosed.

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[14] The use of a "hot link" within the practitioner's report to management's assertion, such as might be used in a WebTrust[SM] report, would meet this requirement. [Footnote renumbered by the issuance of SSAE No. 14, November 2006.]

[15] Specific standards may require that the practitioner express his or her conclusion directly on the subject matter. For example, if management states in its assertion that a material weakness exists in the entity's internal control over financial reporting, the practitioner should state his or her opinion directly on the effectiveness of internal control, not on management's assertion related thereto. [Footnote renumbered by the issuance of SSAE No. 14, November 2006.]

.70 If the criteria used for the subject matter for the current date or period differ from those criteria used for the subject matter for a preceding date or period and the subject matter for the prior date or period is not presented, the practitioner should consider whether the changes in criteria are likely to be significant to users of the report. If so, the practitioner should determine whether the criteria are clearly stated or described and the fact that the criteria have changed is disclosed. (See paragraphs .76–.77.)

.71 The third standard of reporting is—*The practitioner must state all of the practitioner's significant reservations about the engagement, the subject matter, and, if applicable, the assertion related thereto in the report.* [As amended, effective when the subject matter or assertion is as of or for a period ending on or after December 15, 2006, by SSAE No. 14.]

.72 *Reservations about the engagement* refers to any unresolved problem that the practitioner had in complying with these attestation standards, interpretive standards, or the specific procedures agreed to by the specified parties. The practitioner should not express an unqualified conclusion unless the engagement has been conducted in accordance with the attestation standards. Such standards will not have been complied with if the practitioner has been unable to apply all the procedures that he or she considers necessary in the circumstances.

.73 Restrictions on the scope of an engagement, whether imposed by the client or by such other circumstances as the timing of the work or the inability to obtain sufficient evidence, may require the practitioner to qualify the assurance provided, to disclaim any assurance, or to withdraw from the engagement. For example, if the practitioner's client is the responsible party, a failure to obtain a written assertion should result in the practitioner concluding that a scope limitation exists. (See paragraph .58.)

.74 The practitioner's decision to provide a qualified opinion, to disclaim an opinion, or to withdraw because of a scope limitation in an examination engagement depends on an assessment of the effect of the omitted procedure(s) on his or her ability to express assurance. This assessment will be affected by the nature and magnitude of the potential effects of the matters in question, and by their significance to the subject matter or the assertion. If the potential effects are pervasive to the subject matter or the assertion, a disclaimer or withdrawal is more likely to be appropriate. When restrictions that significantly limit the scope of the engagement are imposed by the client or the responsible party, the practitioner generally should disclaim an opinion or withdraw from the engagement. The reasons for a qualification or disclaimer should be described in the practitioner's report.

.75 In a review engagement, when the practitioner is unable to perform the inquiry and analytical or other procedures he or she considers necessary to achieve the limited assurance contemplated by a review, or when the client is the responsible party and does not provide the practitioner with a written assertion, the review will be incomplete. A review that is incomplete is not an adequate basis for issuing a review report and, accordingly, the practitioner should withdraw from the engagement.

.76 *Reservations about the subject matter or the assertion* refers to any unresolved reservation about the assertion or about the conformity of the subject matter with the criteria, including the adequacy of the disclosure of material matters. They can result in either a qualified or an adverse opinion, depending on the materiality of the departure from the criteria against which the subject matter or the assertion was evaluated, or a modified conclusion in a review engagement.

.77 Reservations about the subject matter or the assertion may relate to the measurement, form, arrangement, content, or underlying judgments and assumptions applicable to the subject matter or the assertion and its appended notes, including, for example, the terminology used, the amount of detail given, the classification of items, and the bases of amounts set forth. The practitioner considers whether a particular reservation should affect the report given the circumstances and facts of which he or she is aware at the time.

.78 The fourth standard of reporting is—*The practitioner must state in the report that the report is intended solely for the information and use of the specified parties under the following circumstances:*

- *When the criteria used to evaluate the subject matter are determined by the practitioner to be appropriate only for a limited number of parties who either participated in their establishment or can be presumed to have an adequate understanding of the criteria*
- *When the criteria used to evaluate the subject matter are available only to specified parties*
- *When reporting on subject matter and a written assertion has not been provided by the responsible party*
- *When the report is on an attestation engagement to apply agreed-upon procedures to the subject matter*

[As amended, effective when the subject matter or assertion is as of or for a period ending on or after December 15, 2006, by SSAE No. 14.]

.79 The need for restriction on the use of a report may result from a number of circumstances, including the purpose of the report, the criteria used in preparation of the subject matter, the extent to which the procedures performed are known or understood, and the potential for the report to be misunderstood when taken out of the context in which it was intended to be used. A practitioner should consider informing his or her client that restricted-use reports are not intended for distribution to nonspecified parties, regardless of whether they are included in a document containing a separate general-use report.[16, 17] However, a practitioner is not responsible for controlling a client's distribution of restricted-use reports. Accordingly, a restricted-use report should alert readers to the restriction on the use of the report by indicating that the report is not intended to be and should not be used by anyone other than the specified parties.

.80 An attest report that is restricted as to use should contain a separate paragraph at the end of the report that includes the following elements:

a. A statement indicating that the report is intended solely for the information and use of the specified parties

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[16] In some cases, restricted-use reports filed with regulatory agencies are required by law or regulation to be made available to the public as a matter of public record. Also, a regulatory agency as part of its oversight responsibility for an entity may require access to restricted-use reports in which they are not named as a specified party. [Footnote renumbered by the issuance of SSAE No. 14, November 2006.]

[17] This section does not preclude the practitioner, in connection with establishing the terms of the engagement, from reaching an understanding with the client that the intended use of the report will be restricted, and from obtaining the client's agreement that the client and the specified parties will not distribute the report to parties other than those identified in the report. [Footnote renumbered by the issuance of SSAE No. 14, November 2006.]

b. An identification of the specified parties to whom use is restricted

c. A statement that the report is not intended to be and should not be used by anyone other than the specified parties

An example of such a paragraph is the following.

> This report is intended solely for the information and use of [*the specified parties*] and is not intended to be and should not be used by anyone other than these specified parties.

.81 Other attestation standards may specify situations that require restricted reports such as the following:

a. A review report on management's discussion and analysis

b. A report on prospective financial information when the report is intended for use by the responsible party alone, or by the responsible party and third parties with whom the responsible party is negotiating directly, as described in paragraph .10 of section 301, *Financial Forecasts and Projections*.

Furthermore, nothing in this section precludes a practitioner from restricting the use of any report.

.82 If a practitioner issues a single combined report covering both (*a*) subject matter or presentations that require a restriction on use to specified parties and (*b*) subject matter or presentations that ordinarily do not require such a restriction, the use of such a single combined report should be restricted to the specified parties.

.83 In some instances, a separate restricted-use report may be included in a document that also contains a general-use report. The inclusion of a separate restricted-use report in a document that contains a general-use report does not affect the intended use of either report. The restricted-use report remains restricted as to use, and the general-use report continues to be for general use.

Examination Reports

.84 When expressing an opinion, the practitioner should clearly state whether, in his or her opinion, (*a*) the subject matter is based on (or in conformity with) the criteria in all material respects or (*b*) the assertion is presented (or fairly stated), in all material respects, based on the criteria. Reports expressing an opinion may be qualified or modified for some aspect of the subject matter, the assertion or the engagement (see the third reporting standard). However, as stated in paragraph .66, if conditions exist that, individually or in combination, result in one or more material misstatements or deviations from the criteria, the practitioner should modify the report and, to most effectively communicate with the reader of the report, should ordinarily express his or her conclusion directly on the subject matter, not on the assertion. In addition, such reports may emphasize certain matters relating to the attest engagement, the subject matter, or the assertion. The form of the practitioner's report will depend on whether the practitioner opines on the subject matter or the assertion.

.85 The practitioner's examination report on subject matter should include the following:

a. A title that includes the word *independent*

b. An identification of the subject matter and the responsible party

c. A statement that the subject matter is the responsibility of the responsible party *d.* A statement that the practitioner's responsibility is to express an opinion on the subject matter based on his or her examination

e. A statement that the examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants, and, accordingly, included procedures that the practitioner considered necessary in the circumstances

f. A statement that the practitioner believes the examination provides a reasonable basis for his or her opinion

g. The practitioner's opinion on whether the subject matter is based on (or in conformity with) the criteria in all material respects

h. A statement restricting the use of the report to specified parties under the following circumstances (see paragraphs .78–.83):

(1) When the criteria used to evaluate the subject matter are determined by the practitioner to be appropriate only for a limited number of parties who either participated in their establishment or can be presumed to have an adequate understanding of the criteria

(2) When the criteria used to evaluate the subject matter are available only to the specified parties

(3) When a written assertion has not been provided by the responsible party (The practitioner should also include a statement to that effect in the introductory paragraph of the report.)

i. The manual or printed signature of the practitioner's firm

j. The date of the examination report

Appendix A [paragraph .114], *Examination Reports*, includes a standard examination report on subject matter. (See example 1.)

.86 The practitioner's examination report on an assertion should include the following:

a. A title that includes the word *independent*

b. An identification of the assertion and the responsible party (When the assertion does not accompany the practitioner's report, the first paragraph of the report should also contain a statement of the assertion.)

c. A statement that the assertion is the responsibility of the responsible party

d. A statement that the practitioner's responsibility is to express an opinion on the assertion based on his or her examination

e. A statement that the examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants, and, accordingly, included procedures that the practitioner considered necessary in the circumstances

f. A statement that the practitioner believes the examination provides a reasonable basis for his or her opinion

g. The practitioner's opinion on whether the assertion is presented (or fairly stated), in all material respects, based on the criteria (However, see paragraph .66.)

h. A statement restricting the use of the report to specified parties under the following circumstances (see paragraphs .78–.83):

(1) When the criteria used to evaluate the subject matter are determined by the practitioner to be appropriate only for a limited number of parties who either participated in their establishment

or can be presumed to have an adequate understanding of the criteria

(2) When the criteria used to evaluate the subject matter are available only to the specified parties

i. The manual or printed signature of the practitioner's firm

j. The date of the examination report

Appendix A [paragraph .114] includes a standard examination report on an assertion. (See example 2.)

.87 Nothing precludes the practitioner from examining an assertion but opining directly on the subject matter. (See Appendix A [paragraph .114], example 3.)

Review Reports

.88 In a review report, the practitioner's conclusion should state whether any information came to the practitioner's attention on the basis of the work performed that indicates that (*a*) the subject matter is not based on (or in conformity with) the criteria or (*b*) the assertion is not presented (or fairly stated) in all material respects based on the criteria. (As discussed more fully in the commentary to the third reporting standard, if the subject matter or the assertion is not modified to correct for any such information that comes to the practitioner's attention, such information should be described in the practitioner's report.)

.89 The practitioner's review report on subject matter should include the following:

a. A title that includes the word *independent*

b. An identification of the subject matter and the responsible party

c. A statement that the subject matter is the responsibility of the responsible party

d. A statement that the review was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants

e. A statement that a review is substantially less in scope than an examination, the objective of which is an expression of opinion on the subject matter, and accordingly, no such opinion is expressed

f. A statement about whether the practitioner is aware of any material modifications that should be made to the subject matter in order for it to be based on (or in conformity with), in all material respects, the criteria, other than those modifications, if any, indicated in his or her report

g. A statement restricting the use of the report to specified parties under the following circumstances (see paragraphs .78–.83):

(1) When the criteria used to evaluate the subject matter are determined by the practitioner to be appropriate only for a limited number of parties who either participated in their establishment or can be presumed to have an adequate understanding of the criteria

(2) When the criteria used to evaluate the subject matter are available only to the specified parties

(3) When a written assertion has not been provided by the responsible party and the responsible party is not the client (The practitioner should also include a statement to that effect in the introductory paragraph of the report.)

h. The manual or printed signature of the practitioner's firm

i. The date of the review report

Appendix B [paragraph .115] *Review Reports*, includes a standard review report on subject matter. (See example 1.) Appendix B [paragraph .115] also includes a review report on subject matter that is the responsibility of a party other than client; the report is restricted as to use because a written assertion has not been provided by the responsible party. (See example 2.)

.90 The practitioner's review report on an assertion should include the following:

a. A title that includes the word *independent*

b. An identification of the assertion and the responsible party (When the assertion does not accompany the practitioner's report, the first paragraph of the report should also contain a statement of the assertion.)

c. A statement that the assertion is the responsibility of the responsible party

d. A statement that the review was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants

e. A statement that a review is substantially less in scope than an examination, the objective of which is an expression of opinion on the assertion, and accordingly, no such opinion is expressed

f. A statement about whether the practitioner is aware of any material modifications that should be made to the assertion in order for it to be presented (or fairly stated), in all material respects, based on (or in conformity with) the criteria, other than those modifications, if any, indicated in his or her report (However, see paragraph .66.)

g. A statement restricting the use of the report to specified parties under the following circumstances (see paragraphs .78–.83):

(1) When the criteria used to evaluate the subject matter are determined by the practitioner to be appropriate only for a limited number of parties who either participated in their establishment or can be presumed to have an adequate understanding of the criteria

(2) When the criteria used to evaluate the subject matter are available only to the specified parties

h. The manual or printed signature of the practitioner's firm

i. The date of the review report

Appendix B [paragraph .115] includes a review report on an assertion that is restricted as to use because the criteria are available only to the specified parties. (See example 3.)

Other Information in a Client-Prepared Document Containing the Practitioner's Attest Report[18]

.91 A client may publish various documents that contain information (hereinafter referred to as *other information*) in addition to the practitioner's attest report on subject matter (or on an assertion related thereto). Paragraphs .92–.94 provide guidance to the practitioner when the other information is contained in (*a*) annual reports to holders of securities or beneficial interests, annual reports of organizations for charitable or philanthropic purposes distributed to the public, and annual reports filed with regulatory authorities under the Securities Exchange Act of 1934 or (*b*) other documents to which the practitioner, at the client's request, devotes attention. These paragraphs are not applicable when an attest report appears in a registration statement filed under the Securities Act of 1933. (See AU-C section 920, *Letters for Underwriters and Certain Other Requesting Parties*, and AU-C section 925, *Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933*.) Also, these paragraphs are not applicable to other information on which the practitioner or another practitioner is engaged to issue an opinion. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.92 The practitioner's responsibility with respect to other information in such a document does not extend beyond the information identified in his or her report, and the practitioner has no obligation to perform any procedures to corroborate any other information contained in the document. However, the practitioner should read the other information not covered by the practitioner's report or by the report of the other practitioner and consider whether it, or the manner of its presentation, is materially inconsistent with the information appearing in the practitioner's report. If the practitioner believes that the other information is inconsistent with the information appearing in the practitioner's report, he or she should consider whether the practitioner's report requires revision. If the practitioner concludes that the report does not require revision, he or she should request the client to revise the other information. If the other information is not revised to eliminate the material inconsistency, the practitioner should consider other actions, such as revising his or her report to include an explanatory paragraph describing the material inconsistency, withholding the use of his or her report in the document, or withdrawing from the engagement.

.93 If, while reading the other information for the reasons set forth in paragraph .92, the practitioner becomes aware of information that he or she believes is a material misstatement of fact that is not a material inconsistency as described in paragraph .92, he or she should discuss the matter with the client. In connection with this discussion, the practitioner should consider that he or she may not have the expertise to assess the validity of the statement, that there may be no standards by which to assess its presentation, and that there may be valid differences of judgment or opinion. If the practitioner concludes he or she has a valid basis for concern, the practitioner should propose that the client consult with some other party whose advice may be useful, such as the entity's legal counsel.

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[18] Such guidance pertains only to other information in a client-prepared document. The practitioner has no responsibility to read information contained in documents of nonclients. Further, the practitioner is not required to read information contained in electronic sites, or to consider the consistency of other information in electronic sites with the original documents since electronic sites are a means of distributing information and are not "documents" as that term is used in this section. Practitioners may be asked by their clients to render attest services with respect to information in electronic sites, in which case, other attest standards may apply to those services. [Footnote renumbered by the issuance of SSAE No. 14, November 2006.]

.94 If, after discussing the matter, the practitioner concludes that a material misstatement of fact remains, the action taken will depend on his or her judgment in the circumstances. The practitioner should consider steps such as notifying the client's management and audit committee in writing of his or her views concerning the information and consulting his or her legal counsel about further action appropriate in the circumstances.[19]

Consideration of Subsequent Events in an Attest Engagement

.95 Events or transactions sometimes occur subsequent to the point in time or period of time of the subject matter being tested but prior to the date of the practitioner's report that have a material effect on the subject matter and therefore require adjustment or disclosure in the presentation of the subject matter or assertion. These occurrences are referred to as *subsequent events*. In performing an attest engagement, a practitioner should consider information about subsequent events that comes to his or her attention. Two types of subsequent events require consideration by the practitioner.

.96 The first type consists of events that provide additional information with respect to conditions that existed at the point in time or during the period of time of the subject matter being tested. This information should be used by the practitioner in considering whether the subject matter is presented in conformity with the criteria and may affect the presentation of the subject matter, the assertion, or the practitioner's report.

.97 The second type consists of those events that provide information with respect to conditions that arose subsequent to the point in time or period of time of the subject matter being tested that are of such a nature and significance that their disclosure is necessary to keep the subject matter from being misleading. This type of information will not normally affect the practitioner's report if the information is appropriately disclosed.

.98 While the practitioner has no responsibility to detect subsequent events, the practitioner should inquire of the responsible party (and his or her client if the client is not the responsible party) as to whether they are aware of any subsequent events, through the date of the practitioner's report, that would have a material effect on the subject matter or assertion.[20] If the practitioner has decided to obtain a representation letter, the letter ordinarily would include a representation concerning subsequent events. (See paragraphs .60–.61.)

.99 The practitioner has no responsibility to keep informed of events subsequent to the date of his or her report; however, the practitioner may later become aware of conditions that existed at that date that might have affected the practitioner's report had he or she been aware of them. In such circumstances, the practitioner may wish to consider the guidance in AU-C section

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[19] If the client does not have an audit committee, the practitioner should communicate with individuals whose authority and responsibility are equivalent to those of an audit committee, such as the board of directors, the board of trustees, an owner in a owner-managed entity, or those who engaged the practitioner. [Footnote renumbered by the issuance of Statement on SSAE No. 14, November 2006.]

[20] For certain subject matter, specific subsequent event standards have been developed to provide additional requirements for engagement performance and reporting. Additionally, a practitioner engaged to examine the design or effectiveness of internal control over items not covered by section 501, *An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements*, or section 601, *Compliance Attestation*, should consider the subsequent events guidance set forth in paragraphs .129–.134 of section 501 and paragraphs .50–.52 of section 601. [Footnote renumbered by the issuance of SSAE No. 14, November 2006.]

560, *Subsequent Events and Subsequently Discovered Facts*. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Attest Documentation[21]

.100 The practitioner should prepare and maintain attest documentation, the form and content of which should be designed to meet the circumstances of the particular attest engagement.[22] Attest documentation is the principal record of attest procedures applied, information obtained, and conclusions or findings reached by the practitioner in the engagement. The quantity, type, and content of attest documentation are matters of the practitioner's professional judgment. [As amended, effective for attest engagements when the subject matter or assertion is as of or for a period ending on or after December 15, 2002, by SSAE No. 11.]

.101 Attest documentation serves mainly to:

a. Provide the principal support for the practitioner's report, including the representation regarding observance of the standards of fieldwork, which is implicit in the reference in the report to attestation standards.[23]

b. Aid the practitioner in the conduct and supervision of the attest engagement.

For examinations of prospective financial statements, attest documentation ordinarily should indicate that the process by which the entity develops its prospective financial statements was considered in determining the scope of the examination. [Paragraph added, effective for attest engagements when the subject matter or assertion is as of or for a period ending on or after December 15, 2002, by SSAE No. 11.]

.102 Examples of attest documentation are work programs, analyses, memoranda, letters of confirmation and representation, abstracts or copies of entity documents, and schedules or commentaries prepared or obtained by the practitioner. Attest documentation may be in paper form, electronic form, or other media. [Paragraph renumbered and amended, effective for attest engagements when the subject matter or assertion is as of or for a period ending on or after December 15, 2002, by SSAE No. 11.]

.103 Attest documentation should be sufficient to (*a*) enable members of the engagement team with supervision and review responsibilities to understand the nature, timing, extent, and results of attest procedures performed,

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[21] *Attest documentation* also may be referred to as *working papers*. [Footnote added, effective for attest engagements when the subject matter or assertion is as of or for a period ending on or after December 15, 2002, by SSAE No. 11. Footnote renumbered by the issuance of SSAE No. 14, November 2006.]

[22] [Footnote renumbered and deleted by the issuance of SSAE No. 11, January 2002. Footnote subsequently renumbered by the issuance of SSAE No. 14, November 2006.]

[23] However, there is no intention to imply that the practitioner would be precluded from supporting his or her report by other means in addition to attest documentation. [Footnote added, effective for attest engagements when the subject matter or assertion is as of or for a period ending on or after December 15, 2002, by SSAE No. 11. Footnote renumbered by the issuance of SSAE No. 14, November 2006.]

and the information obtained[24] and (*b*) indicate the engagement team member(s) who performed and reviewed the work. [Paragraph added, effective for attest engagements when the subject matter or assertion is as of or for a period ending on or after December 15, 2002, by SSAE No. 11.]

.104 Attest documentation is the property of the practitioner, and some states recognize this right of ownership in their statutes. The practitioner should adopt reasonable procedures to retain attest documentation for a period of time sufficient to meet the needs of his or her practice and to satisfy any applicable legal or regulatory requirements for records retention.[25, [26]] [Paragraph renumbered and amended, effective for attest engagements when the subject matter or assertion is as of or for a period ending on or after December 15, 2002, by SSAE No. 11.]

.105 The practitioner has an ethical, and in some situations a legal, obligation to maintain the confidentiality of client information or information of the responsible party.[27] Because attest documentation often contains confidential information, the practitioner should adopt reasonable procedures to maintain the confidentiality of that information.[†] [Paragraph added, effective for attest engagements when the subject matter or assertion is as of or for a period ending on or after December 15, 2002, by SSAE No. 11.]

.106 The practitioner also should adopt reasonable procedures to prevent unauthorized access to attest documentation. [Paragraph added, effective for attest engagements when the subject matter or assertion is as of or for a period ending on or after December 15, 2002, by SSAE No. 11.]

.107 Certain attest documentation may sometimes serve as a useful reference source for the client, but it should not be regarded as a part of, or a substitute for, the client's records. [Paragraph renumbered and amended, effective for attest engagements when the subject matter or assertion is as of or for a period ending on or after December 15, 2002, by SSAE No. 11.]

[.108] [Paragraph renumbered and deleted by the issuance of SSAE No. 11, January 2002.]

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[24] A firm of practitioners has a responsibility to adopt a system of quality control policies and procedures to provide the firm with reasonable assurance that its personnel comply with applicable professional standards, including attestation standards, and the firm's standards of quality in conducting individual attest engagements. Review of attest documentation and discussions with engagement team members are among the procedures a firm performs when monitoring compliance with the quality control policies and procedures that it has established. (Also, see paragraphs .17–.18.) [Footnote added, effective for attest engagements when the subject matter or assertion is as of or for a period ending on or after December 15, 2002, by SSAE No. 11. Footnote renumbered by the issuance of SSAE No. 14, November 2006.]

[25] The procedures should enable the practitioner to access electronic attest documentation throughout the retention period. [Footnote added, effective for attest engagements when the subject matter or assertion is as of or for a period ending on or after December 15, 2002, by SSAE No. 11. Footnote renumbered by the issuance of SSAE No. 14, November 2006.]

[[26]] [Footnote renumbered and deleted by the issuance of SSAE No. 11, January 2002. Footnote subsequently renumbered by the issuance of SSAE No. 14, November 2006.]

[27] Also, see the "Confidential Client Information Rule" (ET sec. 1.700.001) of the AICPA Code of Professional Conduct. [Footnote added, effective for attest engagements when the subject matter or assertion is as of or for a period ending on or after December 15, 2002, by SSAE No. 11. Footnote renumbered by the issuance of SSAE No. 14, November 2006. Footnote revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

[†] ***Note:*** See Interpretation No. 4, "Providing Access to or Copies of Attest Documentation to a Regulator," of section 101 (sec. 9101 par. .43–.46).

Attest Services Related to Consulting Service Engagements

Attest Services as Part of a Consulting Service Engagement

.109 When a practitioner provides an attest service (as defined in this section) as part of a consulting service engagement, this SSAE applies only to the attest service. The SSCS applies to the balance of the consulting service engagement. [Paragraph renumbered by the issuance of SSAE No. 11, January 2002.]

.110 When the practitioner determines that an attest service is to be provided as part of a consulting service engagement, the practitioner should inform the client of the relevant differences between the two types of services and obtain concurrence that the attest service is to be performed in accordance with the appropriate professional requirements. The practitioner should take such actions because the professional requirements for an attest service differ from those for a consulting service engagement. [Paragraph renumbered by the issuance of SSAE No. 11, January 2002.]

.111 The practitioner should issue separate reports on the attest engagement and the consulting service engagement and, if presented in a common binder, the report on the attest engagement or service should be clearly identified and segregated from the report on the consulting service engagement. [Paragraph renumbered by the issuance of SSAE No. 11, January 2002.]

Subject Matter, Assertions, Criteria, and Evidence

.112 An attest service may involve subject matter, an assertion, criteria, or evidential matter developed during a concurrent or prior consulting service engagement. Subject matter or an assertion developed with the practitioner's advice and assistance as the result of such consulting services engagement may be the subject of an attest engagement, provided the responsible party accepts and acknowledges responsibility for the subject matter or assertion. (See paragraph .12.) Criteria developed with the practitioner's assistance may be used to evaluate subject matter in an attest engagement, provided such criteria meet the requirements of this section. Relevant information obtained in the course of a concurrent or prior consulting service engagement may be used as evidential matter in an attest engagement, provided the information satisfies the requirements of this section. [Paragraph renumbered by the issuance of SSAE No. 11, January 2002.]

Effective Date

.113 This section is effective when the subject matter or assertion is as of or for a period ending on or after June 1, 2001. Early application is permitted. [Paragraph renumbered by the issuance of SSAE No. 11, January 2002.]

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Appendix A

Examination Reports

Example 1

This is a standard examination report on subject matter for general use. This report pertains to subject matter for which suitable criteria exist and are available to all users through inclusion in a clear manner in the presentation of the subject matter. (See paragraphs .78–.83 for guidance on restricting the use of the report when criteria are available only to specified parties; see Example 4 for an illustration of such a report.) A written assertion has been obtained from the responsible party.

Independent Accountant's Report

We have examined the [*identify the subject matter—for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX*]. XYZ Company's management is responsible for the schedule of investment returns. Our responsibility is to express an opinion based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence supporting [*identify the subject matter—for example, XYZ Company's schedule of investment returns*] and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

[*Additional paragraph(s) may be added to emphasize certain matters relating to the attest engagement or the subject matter.*]

In our opinion, the schedule referred to above presents, in all material respects, [*identify the subject matter—for example, the investment returns of XYZ Company for the year ended December 31, 20XX*] based on [*identify criteria—for example, the ABC criteria set forth in Note 1*].

[*Signature*]

[*Date*]

Example 2

This report is a standard examination report on an assertion for general use. The report pertains to subject matter for which suitable criteria exist and are available to all users through inclusion in a clear manner in the presentation of the subject matter. (See paragraphs .78–.83 for guidance on restricting the use of the report when criteria are available only to specified parties.) A written assertion has been obtained from the responsible party.

Independent Accountant's Report

We have examined management's assertion that [*identify the assertion—for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX is presented in accordance with ABC criteria set forth in Note 1*]. XYZ Company's management is responsible for the assertion. Our responsibility is to express an opinion on the assertion based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence supporting management's assertion and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

[*Additional paragraph(s) may be added to emphasize certain matters relating to the attest engagement or the assertion.*]

In our opinion, management's assertion referred to above is fairly stated, in all material respects, based on [*identify established or stated criteria—for example, the ABC criteria set forth in Note 1*].

[*Signature*]

[*Date*]

Example 3

This is an examination report for general use; the introductory paragraph states the practitioner has examined management's assertion but the practitioner opines directly on the subject matter (see paragraph .87). The report pertains to subject matter for which suitable criteria exist and are available to all users through inclusion in a clear manner in the presentation of the subject matter. (See paragraphs .78–.83 for guidance on restricting the use of the report when criteria are available only to specified parties.) A written assertion has been obtained from the responsible party.

Independent Accountant's Report

We have examined management's assertion that [*identify the assertion—for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX is presented in accordance with the ABC criteria set forth in Note 1*]. XYZ Company's management is responsible for the assertion. Our responsibility is to express an opinion based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence supporting [*identify the subject matter—for example, XYZ Company's schedule of investment returns*] and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

[*Additional paragraph(s) may be added to emphasize certain matters relating to the attest engagement or the assertion.*]

In our opinion, the schedule referred to above, presents, in all material respects, [*identify the subject matter—for example, the investment returns of XYZ Company for the year ended December 31, 20XX*] based on [*identify criteria—for example, the ABC criteria set forth in Note 1*].

[*Signature*]

[*Date*]

Example 4

This is an examination report on subject matter. Although suitable criteria exist, use of the report is restricted because the criteria are available only to specified parties. (See paragraph .34.) A written assertion has been obtained from the responsible party.

<u>Independent Accountant's Report</u>

We have examined the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX. XYZ Company's management is responsible for the schedule of investment returns. Our responsibility is to express an opinion based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence supporting [*identify the subject matter—for example, XYZ Company's schedule of investment returns*] and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

[*Additional paragraph(s) may be added to emphasize certain matters relating to the attest engagement or the assertion.*]

In our opinion, the schedule referred to above, presents, in all material respects, [*identify the subject matter—for example, the investment returns of XYZ Company for the year ended December 31, 20XX*] based on the ABC criteria referred to in the investment management agreement between XYZ Company and DEF Investment Managers, Ltd., dated November 15, 20X1.

This report is intended solely for the information and use of XYZ Company and [*identify other specified parties—for example, DEF Investment Managers, Ltd.*] and is not intended to be and should not be used by anyone other than these specified parties.

[*Signature*]

[*Date*]

Example 5

This is an examination report with a qualified opinion because conditions exist that, individually or in combination, result in one or more material misstatements or deviations from the criteria; the report is for general use. The report pertains to subject matter for which suitable criteria exist and are available to all users through inclusion in a clear manner in the presentation of the subject matter. (See paragraphs .78–.83 for guidance on restricting the use of the report when criteria are available only to specified parties.) A written assertion has been obtained from the responsible party.

<u>Independent Accountant's Report</u>

We have examined the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX. XYZ Company's management is responsible for the schedule of investment returns. Our responsibility is to express an opinion based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence supporting [*identify the subject matter—for example, XYZ Company's schedule of investment returns*] and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

Our examination disclosed the following [*describe condition(s) that, individually or in the aggregate, resulted in a material misstatement or deviation from the criteria*].

In our opinion, except for the material misstatement [*or deviation from the criteria*] described in the preceding paragraph, the schedule referred to above, presents, in all material respects, [*identify the subject matter—for example, the investment returns of XYZ Company for the year ended December 31, 20XX*] based on [*identify criteria—for example, the ABC criteria set forth in Note 1*].

[*Signature*]

[*Date*]

Example 6

This is an examination report that contains a disclaimer of opinion because of a scope restriction. (See paragraph .74 for reporting guidance when there is a scope restriction.) The report pertains to subject matter for which suitable criteria exist and are available to all users through inclusion in a clear manner in the presentation of the subject matter.

Independent Accountant's Report

We were engaged to examine the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX. XYZ Company's management is responsible for the schedule of investment returns.

[*Scope paragraph should be omitted.*]

[*Include paragraph to describe scope restrictions.*]

Because of the restriction on the scope of our examination discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on whether the schedule referred to above presents, in all material respects, [*identify the subject matter—for example, the investment returns of XYZ Company for the year ended December 31, 20XX*] based on [*identify criteria—for example, the ABC criteria set forth in Note 1*].

[*Signature*]

[*Date*]

Example 7

This is an examination report on subject matter that is the responsibility of a party other than the client. The report is restricted as to use since a written assertion has not been provided by the responsible party. (See paragraph .78.) The subject matter pertains to criteria that are suitable and are available to the client.

Independent Accountant's Report

To the Board of Directors

DEF Company:

We have examined the [*identify the subject matter—for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX*]. XYZ Company's management is responsible for the schedule of investment returns. XYZ management did not provide us a written assertion about their schedule of investment returns for the year ended December 31, 20XX. Our responsibility is to express an opinion based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence supporting [*identify the subject matter—for example, XYZ Company's schedule of investment returns*] and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

[*Additional paragraph(s) may be added to emphasize certain matters relating to the attest engagement or the subject matter.*]

In our opinion, the schedule referred to above presents, in all material respects, [*identify the subject matter—for example, the investment returns of XYZ Company for the year ended December 31, 20XX*] based on [*identify criteria—for example, the ABC criteria set forth in Note 1*].

This report is intended solely for the information and use of the management and board of directors of DEF Company and is not intended to be and should not be used by anyone other than these specified parties.

[*Signature*]

[*Date*]

[Paragraph renumbered by the issuance of SSAE No. 11, January 2002.]

.115

Appendix B

Review Reports

Example 1

This is a standard review report on subject matter for general use. The report pertains to subject matter for which suitable criteria exist and are available to all users through inclusion in a clear manner in the presentation of the subject matter. (See paragraphs .78–.83 for guidance on restricting the use of the report when criteria are available only to specified parties.) A written assertion has been obtained from the responsible party.

Independent Accountant's Report

We have reviewed the [*identify the subject matter—for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX*]. XYZ Company's management is responsible for the schedule of investment returns.

Our review was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. A review is substantially less in scope than an examination, the objective of which is the expression of an opinion on [*identify the subject matter—for example, XYZ Company's schedule of investment returns*]. Accordingly, we do not express such an opinion.

[*Additional paragraph(s) may be added to emphasize certain matters relating to the attest engagement or the subject matter.*]

Based on our review, nothing came to our attention that caused us to believe that the [*identify the subject matter—for example, schedule of investment returns of XYZ Company for the year ended December 31, 20XX*] is not presented, in all material respects, in conformity with [*identify the criteria—for example, the ABC criteria set forth in Note 1*].

[*Signature*]

[*Date*]

Example 2

This is a review report on subject matter that is the responsibility of a party other than the client. This review report is restricted as to use since a written assertion has not been provided by the responsible party. (See paragraph .78.) The subject matter pertains to criteria that are suitable and are available to the client.

Independent Accountant's Report

To the Board of Directors

DEF Company:

We have reviewed [*identify the subject matter—for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX*]. XYZ Company's management is responsible for the schedule of investment returns. XYZ Company's management did not provide us a written assertion about their schedule of investment returns for the year ended December 31, 20XX.

Our review was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. A review is substantially less in scope than an examination, the objective of which is the expression of an opinion on [*identify the subject matter—for example, XYZ Company's schedule of investment returns*]. Accordingly, we do not express such an opinion.

[*Additional paragraph(s) may be added to emphasize certain matters relating to the attest engagement or the subject matter.*]

Based on our review, nothing came to our attention that caused us to believe that [*identify the subject matter—for example, the schedule of investment returns of XYZ Company for the year ended December 31, 20XX*] is not presented, in all material respects, in conformity with [*identify the criteria—for example, the ABC criteria set forth in Note 1*].

This report is intended solely for the information and use of the management and board of directors of DEF Company and is not intended to be and should not be used by anyone other than these specified parties.

[*Signature*]

[*Date*]

Example 3

This is a review report on an assertion. Although suitable criteria exist for the subject matter, the report is restricted as to use since the criteria are available only to specified parties; if the criteria are available as described in paragraph .33(*a*)–(*d*), the paragraph restricting the use of the report would be omitted. A written assertion has been obtained from the responsible party.

Independent Accountant's Report

We have reviewed management's assertion that [*identify the assertion—for example, the accompanying schedule of investment returns of XYZ Company for the year ended December 31, 20XX is presented in accordance with the ABC criteria referred to in Note 1*]. XYZ Company's management is responsible for the assertion.

Our review was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. A review is substantially less in scope than an examination, the objective of which is the expression of an opinion on management's assertion. Accordingly, we do not express such an opinion.

[*Additional paragraph(s) may be added to emphasize certain matters relating to the attest engagement or the assertion.*]

Based on our review, nothing came to our attention that caused us to believe that management's assertion referred to above is not fairly stated, in all material respects, based on [*identify the criteria—for example, the ABC criteria referred to in the investment management agreement between XYZ Company and DEF Investment Managers, Ltd., dated November 15, 20X1*].

This report is intended solely for the information and use of XYZ Company and [*identify other specified parties—for example, DEF Investment Managers, Ltd.*] and is not intended to be and should not be used by anyone other than these specified parties.

[*Signature*]

[*Date*]

[Paragraph renumbered by the issuance of SSAE No. 11, January 2002.]

AT Section 9101

Attest Engagements: Attest Engagements Interpretations of Section 101

1. Defense Industry Questionnaire on Business Ethics and Conduct[1]

.01 *Question*—Certain defense contractors have made a commitment to adopt and implement six principles of business ethics and conduct contained in the *Defense Industry Initiatives on Business Ethics and Conduct* (initiatives). One of those principles concerns defense contractors' public accountability for their commitment to the initiatives. That public accountability begins by the contractor completing an annual *Public Accountability Questionnaire* (questionnaire).

.02 Each of the participating signatory companies (signatories) completes a questionnaire concerning certain policies, procedures, and programs that were to have been in place during the reporting period. The public accountability process requires signatories to perform internal audits and to provide officer certifications as to whether the responses to the questionnaire are current and accurate.

.03 Alternatively, a defense contractor may request its independent public accountant (practitioner) to examine or review its responses to the questionnaire for the purpose of expressing a conclusion about the appropriateness of those responses in a report. Would such an engagement be an attest engagement under section 101, *Attest Engagements*?

.04 *Interpretation*—Section 101 states that the attestation standards apply when a CPA in public practice is engaged to issue or does issue an examination, a review, or an agreed-upon procedures report on subject matter, or an assertion about the subject matter that is the responsibility of another party. When a practitioner is engaged by a defense contractor to provide an examination or a review report on the contractor's written responses to the questionnaire, such an engagement involves subject matter that is the responsibility of the defense contractor. Consequently, section 101 applies to such engagements.

.05 *Question*—Paragraph .23 of section 101 specifies that "the practitioner must have reason to believe that the subject matter is capable of evaluation against criteria that are suitable and available to users." What are the criteria against which such subject matter is to be evaluated and are such criteria suitable and available?

.06 *Interpretation*—The criteria for evaluating the defense contractor's responses are set forth primarily in the questionnaire and the instructions thereto. The suitability of those criteria should be evaluated by assessing whether the criteria meet the characteristics discussed in paragraph .24 of section 101.

.07 The criteria set forth in the questionnaire and its instructions will, when properly followed, be suitable. Although these should provide suitable

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[1] Information regarding the Defense Industry Initiative on Business Ethics and Conduct (DII) is available at DII's website www.dii.org.

criteria, the questionnaire and its instructions are not generally available. Therefore, the practitioner's report should normally be restricted. The availability requirement can be met if the defense contractor attaches the criteria to the presentation.

.08 *Question*—What is the nature of the procedures that should be applied to the questionnaire responses?

.09 *Interpretation*—The objective of the procedures performed in either an examination or a review engagement is to obtain evidential matter that the defense contractor has designed and placed in operation policies and programs in a manner that supports the signatory's responses to each of the questions on the questionnaire and that the policies and programs operated during the period covered by the questionnaire. The objective does not include providing assurance about whether the defense contractor's policies and programs operated effectively to ensure compliance with the defense contractor's code of business ethics and conduct on the part of individual employees or about whether the defense contractor and its employees have complied with federal procurement laws. In an examination, the evidential matter should be sufficient to limit attestation risk to a level that is appropriately low for the high degree of assurance imparted by an examination report. In a review, this evidential matter should be sufficient to limit attestation risk to a moderate level.

.10 Examination procedures include obtaining evidential matter by reading relevant policies and programs, making inquiries of appropriate defense contractor personnel, inspecting documents and records, confirming defense contractor assertions with its employees or others, and observing activities. In an examination it will be necessary for a practitioner's procedures to go beyond simply reading relevant policies and programs and making inquiries of appropriate defense contractor personnel. Alternatively, review procedures are generally limited to reading relevant policies and procedures and making inquiries of appropriate defense contractor personnel. When applying examination or review procedures, the practitioner should assess the appropriateness (including the comprehensiveness) of the policies and programs supporting the signatory's responses to each of the questions on the questionnaire.

.11 A particular defense contractor's policies and programs may vary from those of other defense contractors. As a result, evidential matter obtained from the procedures performed cannot be evaluated solely on a quantitative basis. Consequently, it is not practicable to establish only quantitative guidelines for determining the nature or extent of the evidential matter that is necessary to provide the assurance required in either an examination or a review. The qualitative aspects should also be considered.

.12 In determining the nature, timing, and extent of examination or review procedures, the practitioner should consider information obtained in the performance of other services for the defense contractor, for example, the audit of the defense contractor's financial statements. For multi-location defense contractors, whether policies and programs operated during the period should be evaluated for both the defense contractor's headquarters and for selected defense contracting locations. The practitioner may consider using the work of the defense contractor's internal auditors. AU-C section 610, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*, may be useful in that consideration.

.13 Examination procedures, and in some instances review procedures, may require access to information involving specific instances of actual or alleged noncompliance with laws. An inability to obtain access to such information because of restrictions imposed by a defense contractor (for example, to protect attorney-client privilege) may constitute a scope limitation. Paragraphs .73–.75 of section 101 provide guidance in such situations. The practitioner should assess the effect of the inability to obtain access to such information on his or her ability to form a conclusion about whether the related policy or program operated during the period. If the defense contractor's reasons for not permitting access to the information are reasonable (for example, the information is the subject of litigation or a governmental investigation) and have been approved by an executive officer of the defense contractor, the occurrences of restricted access to information are few in number, and the practitioner has access to other information about that specific instance or about other instances that is sufficient to permit a conclusion to be formed about whether the related policy or program operated during the period, the practitioner ordinarily would conclude that it is not necessary to disclaim assurance.

.14 If the practitioner's scope of work has been restricted with respect to one or more questions, the practitioner should consider the implications of that restriction on the practitioner's ability to form a conclusion about other questions. In addition, as the nature or number of questions on which the defense contractor has imposed scope limitations increases in significance, the practitioner should consider whether to withdraw from the engagement.

.15 *Question*—What is the form of report that should be issued to meet the requirements of section 101?

.16 *Interpretation*—The standards of reporting in section 101 provide guidance about report content and wording and the circumstances that may require report modification. Appendix A and appendix B provide illustrative reports appropriate for various circumstances. Paragraph .66 of section 101 permits the practitioner to report directly on the subject matter or on management's assertion. In either case, the practitioner should ordinarily obtain a written assertion. An illustrative defense contractor assertion is also presented in appendix A and appendix B.

.17 The engagements addressed in this interpretation do not include providing assurance about whether the defense contractor's policies and programs operated effectively to ensure compliance with the defense contractor's code of business ethics and conduct on the part of individual employees or about whether the defense contractor and its employees have complied with federal procurement laws. The practitioner's report should explicitly disclaim an opinion on the extent of such compliance.

.18 Because variations in individual performance and interpretation will affect the operation of the defense contractor's policies and programs during the period, adherence to all such policies and programs in every case may not be possible. In determining whether a reservation about a response in the questionnaire is sufficiently significant to result in an opinion modified for an exception to that response, the practitioner should consider the nature, causes, patterns, and pervasiveness of the instances in which the policies and programs did not operate as designed and their implications for that response in the questionnaire.

.19 When scope limitations have precluded the practitioner from forming an opinion on the responses to one or more questions, the practitioner's report should describe all such scope restrictions. If the defense contractor imposed such a scope limitation after the practitioner had begun performing procedures, that fact should be stated in the report.

.20 A defense contractor may request the practitioner to communicate to management, the board of directors, or one of its committees, either orally or in writing, conditions noted that do not constitute significant reservations about the answers to the questionnaire but that might nevertheless be of value to management. Agreed-upon arrangements between the practitioner and the defense contractor to communicate conditions noted may include, for example, the reporting of matters of less significance than those contemplated by the criteria, the existence of conditions specified by the defense contractor, the results of further investigation of matters noted to identify underlying causes, or suggestions for improvements in various policies or programs. Under these arrangements, the practitioner may be requested to visit specific locations, assess the effectiveness of specific policies or programs, or undertake specific procedures not otherwise planned. In addition, the practitioner is not precluded from communicating matters believed to be of value, even if no specific request has been made.

.21

Appendix A

Illustrative Defense Contractor Assertions and Examination Reports

Defense Industry Questionnaire on Business Ethics and Conduct

Illustration 1: Unqualified Opinion; General-Use Report; Criteria Attached to the Presentation

Defense Contractor Assertion

Statement of Responses to the Defense Industry Questionnaire on *Business Ethics and Conduct for the period from _______ to _______.*

The affirmative responses in the accompanying *Questionnaire on Business Ethics and Conduct with Responses by the XYZ Company for the period from _______ to _______* are based on policies and programs in operation for that period and are appropriately presented in conformity with the criteria set forth in the *Defense Industry Initiatives on Business Ethics and Conduct*, including the Questionnaire.

Attachments:

Defense Industry Initiatives on Business Ethics and Conduct

Instructions and Questionnaire on Business Ethics and Conduct with Responses by the XYZ Company for the period from _______ to _______.

Examination Report

Independent Accountant's Report

To the Board of Directors of the XYZ Company

We have examined the XYZ Company's *Statement of Responses to the Defense Industry Questionnaire on Business Ethics and Conduct for the period from _______ to _______*, and the Questionnaire and responses attached thereto. XYZ Company's management is responsible for its responses to the Questionnaire. Our responsibility is to express an opinion based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence as to whether XYZ Company had policies and programs in operation during that period that support the affirmative responses to the *Questionnaire* and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. Our examination procedures were not designed, however, to evaluate whether the aforementioned policies and programs operated effectively to ensure compliance with the Company's *Code of Business Ethics and Conduct* on the part of individual employees or to evaluate the extent to which the Company or its employees have complied with federal procurement laws, and we do not express an opinion or any other form of assurance thereon.

In our opinion, the affirmative responses in the Questionnaire accompanying the *Statement of Responses to the Defense Industry Questionnaire on Business Ethics and Conduct for the period from _______ to _______* referred to above are appropriately presented in conformity with the criteria set forth in the *Defense Industry Initiatives on Business Ethics and Conduct*, including the Questionnaire.

Illustration 2: Unqualified Opinion; Report Modified for Negative Responses to Defense Contractor Assertion; Use of the Report is Restricted Because Criteria are Available Only to Specified Parties

Defense Contractor Assertion

Statement of Responses to the Defense Industry Questionnaire on *Business Ethics and Conduct for the period from _______ to _______.*

The affirmative responses in the accompanying *Questionnaire on Business Ethics and Conduct with Responses by the XYZ Company for the period from _______ to _______* are based on policies and programs in operation for that period and are appropriately presented in conformity with the criteria set forth in the *Defense Industry Initiatives on Business Ethics and Conduct*, including the Questionnaire. Negative responses indicate that the Company did not have policies and programs in operation during that period with respect to those areas.

Attachments: None

(The responses could include an explanation of negative responses if the defense contractor so desired.)

Examination Report

Independent Accountant's Report

To the Board of Directors of the XYZ Company

We have examined the XYZ Company's *Statement of Responses to the Defense Industry Questionnaire on Business Ethics and Conduct for the period from _______ to _______.* XYZ Company's management is responsible for its responses to the Questionnaire. Our responsibility is to express an opinion based on our examination.

[*Standard Scope Paragraph*]

In our opinion, the affirmative responses in the Questionnaire referred to above are appropriately presented in conformity with the criteria set forth in the *Defense Industry Initiatives on Business Ethics and Conduct*, including the Questionnaire. The negative responses to Questions _______ and _______ in the Questionnaire indicate that the Company did not have policies and programs in operation during the period with respect to those areas.

This report is intended solely for the information and use of the XYZ Company and [*identify other specified parties—for example,* the Defense Industry Initiative] and is not intended to be and should not be used by anyone other than these specified parties.

Illustration 3: Opinion Modified for Exception on Certain Response

Defense Contractor Assertion

Statement of Responses to the Defense Industry Questionnaire on *Business Ethics and Conduct for the period from _______ to _______ .*

The affirmative responses in the accompanying *Questionnaire on Business Ethics and Conduct with Responses by the XYZ Company for the period from _______ to _______*, are based on policies and programs in operation for that period and are appropriately presented in conformity with the criteria set forth in the *Defense Industry Initiatives on Business Ethics and Conduct*, including the Questionnaire.

Attachments:

Defense Industry Initiatives on Business Ethics and Conduct

Questionnaire on Business Ethics and Conduct with Responses by the XYZ Company for the period from _______ to _______ .

Examination Report

Independent Accountant's Report

To the Board of Directors of the XYZ Company

[*Standard Introductory and Scope Paragraphs*]

Management believes that an appropriate mechanism exists for informing employees of the results of any follow-up into their charges of violations of the Company's Code of Business Ethics and Conduct, and has accordingly answered Question 12 in the affirmative. That mechanism consists principally of distributing newspaper articles and press releases of violations of federal procurement laws that have been voluntarily reported to the appropriate governmental agencies. We do not believe that such a mechanism is sufficient, inasmuch as it does not provide follow-up information on violations reported by employees that are not deemed reportable to a governmental agency. Consequently, in our opinion, the affirmative response to Question 12 in the Questionnaire is not appropriately presented in conformity with the criteria set forth in the *Defense Industry Initiatives on Business Ethics and Conduct*, including the Questionnaire.

In our opinion, except for the response to Question 12 as discussed in the preceding paragraph, the affirmative responses in the Questionnaire accompanying the *Statement of Responses to the Defense Industry Questionnaire on Business Ethics and Conduct for the period from _______ to _______* referred to above are appropriately presented in conformity with the criteria set forth in the Defense Industry Initiatives on Business Ethics and Conduct, including the Questionnaire.

Illustration 4: Opinion Modified for Exception on a Certain Response; Report also Modified for Negative Responses

Defense Contractor Assertion

Statement of Responses to the *Defense Industry Questionnaire on Business Ethics and Conduct for the period from _______ to _______.*

The affirmative responses in the accompanying *Questionnaire on Business Ethics and Conduct with Responses by the XYZ Company for the period from _______ to _______* are based on policies and programs in operation for that period and are appropriately presented in conformity with the criteria set forth in the *Defense Industry Initiatives on Business Ethics and Conduct*, including the Questionnaire. Negative responses indicate that the Company did not have policies and programs in operation during that period with respect to those areas.

Attachments:

Defense Industry Initiatives on Business Ethics and Conduct

Questionnaire on Business Ethics and Conduct with Responses by the XYZ Company for the period from _______ to _______.

(The responses could include an explanation of negative responses if the defense contractor so desired.)

Examination Report

Independent Accountant's Report

To the Board of Directors of the XYZ Company

[*Standard Introductory and Scope Paragraphs*]

Management believes that an appropriate mechanism exists for letting employees know of the results of any follow-up into their charges of violations of the Company's Code of Business Ethics and Conduct, and has accordingly answered Question 12 in the affirmative. That mechanism consists principally of distributing newspaper articles and press releases of violations of federal procurement laws that have been voluntarily reported to the appropriate governmental agencies. We do not believe that such a mechanism is sufficient, inasmuch as it does not provide follow-up information on violations reported by employees that are not deemed reportable to a governmental agency. Consequently, in our opinion, the affirmative response to Question 12 in the Questionnaire is not appropriately presented in conformity with the criteria set forth in the Defense Industry Initiatives on Business Ethics and Conduct, including the Questionnaire.

In our opinion, except for the response to Question 12 as discussed in the preceding paragraph, the affirmative responses in the Questionnaire accompanying the *Statement of Responses to the Defense Industry Questionnaire on Business Ethics and Conduct for the period from _______ to _______* referred to above are appropriately presented in conformity with the criteria set forth in the *Defense Industry Initiatives on Business Ethics and Conduct*, including the Questionnaire. The negative responses to Questions _______ and _______ in the Questionnaire indicate that the Company did not have policies and programs in operation during the period with respect to those areas.

Illustration 5: Opinion Disclaimed on Certain Responses Because of Scope Restrictions Imposed by Client

Defense Contractor Assertion

Statement of Responses to the Defense Industry Questionnaire on *Business Ethics and Conduct for the period from _______ to _______.*

The affirmative responses in the accompanying *Questionnaire on Business Ethics and Conduct with Responses by the XYZ Company for the period from _______ to _______* are based on policies and programs in operation for that period and are appropriately presented in conformity with the criteria set forth in the *Defense Industry Initiatives on Business Ethics and Conduct*, including the Questionnaire.

Attachments:

Defense Industry Initiatives on Business Ethics and Conduct

Questionnaire on Business Ethics and Conduct with Responses by the XYZ Company for the period from _______ to _______.

Examination Report

Independent Accountant's Report

To the Board of Directors of the XYZ Company

[*Standard Introductory Paragraph*]

Except as described below, our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence as to whether XYZ Company had policies and programs in operation during that period that support the affirmative responses to the *Questionnaire*. We believe that our examination provides a reasonable basis for our opinion. Our examination procedures were not designed, however, to evaluate whether the aforementioned policies and programs operated effectively to ensure compliance with the Company's *Code of Business Ethics and Conduct* on the part of individual employees or to evaluate the extent to which the Company or its employees have complied with federal procurement laws, and we do not express an opinion or any other form of assurance thereon.

We were not permitted to read relevant documents and files or interview appropriate employees to determine that the affirmative answers to Questions 6, 7, and 8 are appropriate. The nature of those questions precluded us from satisfying ourselves as to the appropriateness of those answers by means of other examination procedures.

In our opinion, the affirmative responses to Questions 1 through 5 and 9 through 17 in the Questionnaire accompanying the *Statement of Responses to the Defense Industry Questionnaire on Business Ethics and Conduct for the period from _______ to _______* referred to above are appropriately presented in conformity with the criteria set forth in the *Defense Industry Initiatives on Business Ethics and Conduct*, including the Questionnaire. Because of the matters discussed in the preceding paragraph, the scope of our work was not sufficient to express, and we do not express, an opinion on the appropriateness of the affirmative responses to Questions 6, 7, and 8 in the Questionnaire.

.22

Appendix B

Illustrative Defense Contractor Assertion and Review Report; Use of Report Is Restricted Because Criteria Are Available Only To Specified Parties

Defense Industry Questionnaire on Business Ethics and Conduct

Defense Contractor Assertion

Statement of Responses to the Defense Industry Questionnaire on *Business Ethics and Conduct for the period from ________to ________.*

The affirmative responses in the accompanying *Questionnaire on Business Ethics and Conduct with Responses by the XYZ Company for the period from ________to* ________are based on policies and programs in operation during that period and are appropriately presented in conformity with the criteria set forth in the *Defense Industry Initiatives on Business Ethics and Conduct*, including the Questionnaire.

Attachments: None

Review Report

Independent Accountant's Report

To the Board of Directors of the XYZ Company

We have reviewed the XYZ Company's *Statement of Responses to the Defense Industry Questionnaire on Business Ethics and Conduct for the period from ________ to _______.* XYZ Company's management is responsible for the Statement of Responses to the Defense Industry Questionnaire on Business Ethics.

Our review was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. A review is substantially less in scope than an examination, the objective of which is the expression of an opinion on the affirmative responses in the Questionnaire. Accordingly, we do not express such an opinion. Additionally, our review was not designed to evaluate whether the aforementioned policies and programs operated effectively to ensure compliance with the Company's *Code of Business Ethics and Conduct* on the part of individual employees or to evaluate the extent to which the Company or its employees have complied with federal procurement laws and we do not express an opinion or any other form of assurance thereon.

Based on our review, nothing came to our attention that caused us to believe that the affirmative responses in the Questionnaire referred to above are not appropriately presented in conformity with the criteria set forth in the *Defense Industry Initiatives on Business Ethics and Conduct*, including the Questionnaire.

This report is intended solely for the information and use of the XYZ Company and [*identify other specified parties—for example,* the Defense Industry Initiative] and is not intended to be and should not be used by anyone other than these specified parties.

[Issue Date: August 1987; Amended: February 1989;
Modified: May 1989; Revised: January 2001; November 2006; Revised:
December 2012; Revised: January 2015.]

2. Responding to Requests for Reports on Matters Relating to Solvency

.23 *Question*—Lenders, as a requisite to the closing of certain secured financings in connection with leveraged buyouts, recapitalizations and certain other financial transactions, have sometimes requested written assurance from an accountant regarding the prospective borrower's solvency and related matters.[2] The lender is concerned that such financings not be considered to include a fraudulent conveyance or transfer under the Federal Bankruptcy Code[3] or the relevant state fraudulent conveyance or transfer statute.[4] If the financing is subsequently determined to have included a fraudulent conveyance or transfer, repayment obligations and security interests may be set aside or subordinated to the claims of other creditors.

.24 May a practitioner provide assurance concerning *matters relating to solvency* as hereinafter defined?

.25 *Interpretation*—No. For reasons set forth subsequently, a practitioner should not provide any form of assurance, through examination, review, or agreed-upon procedures engagements, that an entity

- is not insolvent at the time the debt is incurred or would not be rendered insolvent thereby.
- does not have unreasonably small capital.
- has the ability to pay its debts as they mature.

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[2] Although this interpretation describes requests from secured lenders and summarizes the potential effects of fraudulent conveyance or transfer laws upon such lenders, the interpretation is not limited to requests from lenders. All requests for assurance on matters relating to solvency are governed by this interpretation.

[3] Section 548 of the Federal Bankruptcy Code defines *fraudulent transfers and obligations* as follows:

> The trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily—
>
> (1) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer occurred or such obligation was incurred, indebted; or
>
> (2)(A) received less than a reasonably equivalent value in exchange for such transfer or obligation; and
>
> (2)(B)(i) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;
>
> (2)(B)(ii) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; or
>
> (2)(B)(iii) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured. (Bankruptcy Law Reporter, 3 vols. [Chicago: Commerce Clearing House, 1986], vol. 1, 1339).

[4] State fraudulent conveyance or transfer statutes such as the Uniform Fraudulent Conveyance Act and the Uniform Fraudulent Transfer Act reflect substantially similar provisions. These state laws may be employed absent a declaration of bankruptcy or by a bankruptcy trustee under Section 544(1) of the Federal Bankruptcy Code. Although the statute of limitations varies from state to state, in some states financing transactions may be vulnerable to challenge for up to six years from closing.

In the context of particular transactions other terms are sometimes used or defined by the parties as equivalents of or substitutes for the terms listed above (for example, *fair salable value of assets exceeds liabilities*). These terms, and those matters listed previously, are hereinafter referred to as *matters relating to solvency*. The prohibition extends to providing assurance concerning all such terms.

.26 The third general attestation standard states that the practitioner must have reason to believe that the subject matter is capable of evaluation against criteria that are suitable and available to users. Suitable criteria must have each of the following attributes:

- *Objectivity*—Criteria should be free from bias.
- *Measurability*—Criteria should permit reasonably consistent measurements, qualitative or quantitative, of subject matter.
- *Completeness*—Criteria should be sufficiently complete so those relevant factors that would alter a conclusion about subject matter are not omitted.
- *Relevance*—Criteria should be relevant to the subject matter.

In addition, the second general attestation standard states that the practitioner must have adequate knowledge of the subject matter.

.27 The matters relating to solvency mentioned in paragraph .23 are subject to legal interpretation under, and varying legal definition in, the Federal Bankruptcy Code and various state fraudulent conveyance and transfer statutes. Because these matters are not clearly defined in an accounting sense, and are therefore subject to varying interpretations, they do not provide the practitioner with suitable criteria required to evaluate the subject matter or an assertion under the third general attestation standard. In addition, lenders are concerned with legal issues on matters relating to solvency and the practitioner is generally unable to evaluate or provide assurance on these matters of legal interpretation. Therefore, practitioners are precluded from giving any form of assurance on matters relating to solvency or any financial presentation of matters relating to solvency.

.28 Under existing AICPA standards, the practitioner may provide a client with various professional services that may be useful to the client in connection with a financing. These services include the following:

- Audit of historical financial statements
- Review of historical financial information (a review in accordance with AU-C section 930, *Interim Financial Information*, of interim financial information, or in accordance with AR section 90, *Review of Financial Statements*)
- Examination or review of pro forma financial information (section 401, *Reporting on Pro Forma Financial Information*)
- Examination or compilation of prospective financial information (section 301, *Financial Forecasts and Projections*)

.29 In addition, under existing AICPA attestation standards (section 201, *Agreed-Upon Procedures Engagements*), the practitioner can provide the client and lender with an agreed-upon procedures report. In such an engagement, a client and lender may request that specified procedures be applied to various financial presentations, such as historical financial information, pro forma financial information, and prospective financial information, which can be useful to a client or lender in connection with a financing.

.30 The practitioner should be aware that certain of the services described in paragraph .28 require that the practitioner have an appropriate level of knowledge of the entity's accounting and financial reporting practices and its internal control. This has ordinarily been obtained by the practitioner auditing historical financial statements of the entity for the most recent annual period or by otherwise obtaining an equivalent knowledge base. When considering acceptance of an engagement relating to a financing, the practitioner should consider whether he or she can perform these services without an equivalent knowledge base.

.31 A report on agreed-upon procedures should not provide any assurances on matters relating to solvency or any financial presentation of matters relating to solvency (for example, fair salable value of assets less liabilities or fair salable value of assets less liabilities, contingent liabilities, and other commitments). A practitioner's report on the results of applying agreed-upon procedures should contain the report elements set forth in paragraph .31 of section 201 (or paragraph .55 of section 301 if applying agreed upon procedures to prospective financial information). The practitioner's report on the results of applying agreed-upon procedures should state that

- the service has been requested in connection with a financing (no reference should be made to any solvency provisions in the financing agreement).
- no representations are provided regarding questions of legal interpretation.
- no assurance is provided concerning the borrower's (*a*) solvency, (*b*) adequacy of capital, or (*c*) ability to pay its debts.
- the procedures should not be taken to supplant any additional inquiries and procedures that the lender should undertake in its consideration of the proposed financing.
- where applicable, an audit of recent historical financial statements has previously been performed and that no audit of any historical financial statements for a subsequent period has been performed. In addition, if any services have been performed pursuant to paragraph .28, they may be referred to.

.32 The report ordinarily is dated at or shortly before the closing date. The financing agreement ordinarily specifies the date, often referred to as the cutoff date, to which the report is to relate (for example, a date three business days before the date of the report). The report should state that the inquiries and other procedures carried out in connection with the report did not cover the period from the cutoff date to the date of the report.

.33 The practitioner might consider furnishing the client with a draft of the agreed-upon procedures report. The draft report should deal with all matters expected to be covered in the terms expected to be used in the final report. The draft report should be identified as a draft in order to avoid giving the impression that the procedures described therein have been performed. This practice of furnishing a draft report at an early point permits the practitioner to make clear to the client and lender what they may expect the accountant to furnish and gives them an opportunity to change the financing agreement or the agreed-upon procedures if they so desire.

[Issue Date: May 1988; Amended: February 1993;
Revised: January 2001; November 2006; Revised: December 2012.]

3. Applicability of Attestation Standards to Litigation Services

.34 *Question*—Paragraph .04 of section 101 provides an example of a litigation service provided by practitioners that would not be considered an attest engagement as defined by section 101. When does section 101 not apply to litigation service engagements?

.35 *Interpretation*—Section 101 does not apply to litigation services that involve pending or potential formal legal or regulatory proceedings before a *trier of fact* [5] in connection with the resolution of a dispute between two or more parties in any of the following circumstances when the

a. practitioner has not been engaged to issue and does not issue an examination, a review, or an agreed-upon procedures report on subject matter, or an assertion about the subject matter that is the responsibility of another party.

b. service comprises being an expert witness.

c. service comprises being a trier of fact or acting on behalf of one.

d. practitioner's work under the rules of the proceedings is subject to detailed analysis and challenge by each party to the dispute.

e. practitioner is engaged by an attorney to do work that will be protected by the attorney's work product privilege and such work is not intended to be used for other purposes.

When performing such litigation services, the practitioner should comply with the "General Standards Rule" (ET sec. 1.300.001) of the AICPA Code of Professional Conduct. [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

.36 *Question*—When does section 101 apply to litigation service engagements?

.37 *Interpretation*—Section 101 applies to litigation service engagements only when the practitioner is engaged to issue or does issue an examination, a review, or an agreed-upon procedures report on subject matter, or an assertion about the subject matter, that is the responsibility of another party.

.38 *Question*—Paragraph .04(*c*) of section 101 provides the following example of litigation service engagements that are not considered attest engagements: "Services performed in accordance with the Statement on Standards for Consulting Services, such as. . . . engagements in which a practitioner is engaged to testify as an expert witness in accounting, auditing, taxation, or other matters, given certain stipulated facts."

What does the term *stipulated facts* as used in paragraph .04(*c*) of section 101 mean?

.39 *Interpretation*—The term *stipulated facts* as used in paragraph .04(*c*) of section 101 means facts or assumptions that are specified by one or more parties to a dispute to serve as the basis for the development of an expert opinion. It is not used in its typical legal sense of facts agreed to by all parties involved in a dispute.

.40 *Question*—Does Interpretation No. 2, "Responding to Requests for Reports on Matters Relating to Solvency," of section 101 (par. .23–.33), prohibit

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[5] A *trier of fact* in this section means a court, regulatory body, or government authority; their agents; a grand jury; or an arbitrator or mediator of the dispute.

a practitioner from providing expert testimony, as described in paragraph .04(*c*) of section 101 before a trier of fact on matters relating to solvency?

.41 *Interpretation*—No. Matters relating to solvency mentioned in paragraph .25 are subject to legal interpretation under, and varying legal definition in, the Federal Bankruptcy Code and various state fraudulent conveyance and transfer statutes. Because these matters are not clearly defined in an accounting sense, and therefore subject to varying interpretations, they do not provide the practitioner with the suitable criteria required to evaluate the assertion. Thus, Interpretation No. 2 (par. .23–.33) prohibits a practitioner from providing any form of assurance in reporting upon examination, review, or agreed-upon procedures engagements about matters relating to solvency (as defined in paragraph .25).

.42 However, a practitioner who is involved with pending or potential formal legal or regulatory proceedings before a trier of fact in connection with the resolution of a dispute between two or more parties may provide an expert opinion or consulting advice about matters relating to solvency. The prohibition in paragraphs .23–.33 does not apply in such engagements because as part of the legal or regulatory proceedings, each party to the dispute has the opportunity to analyze and challenge the legal definition and interpretation of the matters relating to solvency and the criteria the practitioner uses to evaluate matters related to solvency. Such services are not intended to be used by others who do not have the opportunity to analyze and challenge such definitions and interpretations.

[Issue Date: July 1990; Revised: January 2001.]

4. Providing Access to or Copies of Attest Documentation to a Regulator

.43 *Question*—Interpretation No. 1, "Providing Access to or Copies of Audit Documentation to a Regulator," of AU-C section 230, *Audit Documentation* (AU-C sec. 9230 par .01–.15), contains guidance relating to providing access to or copies of audit documentation to a regulator. Is this guidance applicable to an attest engagement when a regulator requests access to or copies of the attest documentation?

.44 *Interpretation*—Yes. The guidance in Interpretation No. 1 (AU sec. 9230 par .01–.15) is applicable in these circumstances; however, the letter to a regulator should be tailored to meet the individual engagement characteristics or the purpose of the regulatory request, for example, a quality control review. Illustrative letters for an examination engagement performed in accordance with section 601, *Compliance Attestation*, and an agreed-upon procedures engagement performed in accordance with section 201, follow.

.45 Illustrative letter for examination engagement:

Illustrative Letter to Regulator[6]

[*Date*]

[*Name and Address of Regulatory Agency*]

Your representatives have requested access to our attest documentation in connection with our engagement to examine (*identify the subject matter examined*

[6] The practitioner should appropriately modify this letter when the engagement has been conducted in accordance with Statements on Standards for Attestation Engagements (SSAE) and also in accordance with additional attest requirements specified by a regulatory agency (for example, the requirements specified in *Government Auditing Standards* issued by the Comptroller General of the United States).

or restate management's assertion). It is our understanding that the purpose of your request is (*state purpose*: for example, "to facilitate your regulatory examination").[7]

Our examination was conducted in accordance with attestation standards[8] established by the American Institute of Certified Public Accountants, the objective of which is to form an opinion as to whether the subject matter (or management's assertion) is fairly stated, in all material respects, based on (*identify criteria*). Under these standards, we have the responsibility to plan and perform our examination to provide a reasonable basis for our opinion and to exercise due professional care in the performance of our examination. Our examination is subject to the inherent risk that material noncompliance, if it exists, would not be detected. In addition, our examination does not address the possibility that material noncompliance may occur in the future. Also, our use of professional judgment and the assessments of attestation risk and materiality for the purpose of our examination means that matters may have existed that would have been assessed differently by you. Our examination does not provide a legal determination on (*name of entity*)'s compliance with specified requirements.

The attest documentation was prepared for the purpose of providing the principal support for our opinion on (*name of entity*)'s compliance and to aid in the performance and supervision of our examination. The attest documentation is the principal record of attest procedures performed, information obtained, and conclusions reached in the examination. The procedures that we performed were limited to those we considered necessary under attestation standards[9] established by the American Institute of Certified Public Accountants to provide us with reasonable basis for our opinion. Accordingly, we make no representation as to the sufficiency or appropriateness, for your purposes, of either the procedures or information in our attest documentation. In addition, any notations, comments, and individual conclusions appearing on any of the attest documentation do not stand alone and should not be read as an opinion on any part of management's assertion or the related subject matter.

Our examination was conducted for the purpose stated above and was not planned or performed in contemplation of your (*state purpose*: for example, "regulatory examination"). Therefore, items of possible interest to you may not have been specifically addressed. Accordingly, our examination, and the attest documentation prepared in connection therewith, should not supplant other inquiries and procedures that should be undertaken by the (*name of regulatory agency*) for the purpose of monitoring and regulating (*name of entity*). In addition, we have not performed any procedures since the date of our report with respect to the subject matter (*or management's assertion related thereto*), and significant events or circumstances may have occurred since that date.

The attest documentation constitutes and reflects work performed or information obtained by us in the course of our examination. The documents contain trade secrets and confidential commercial and financial information of our firm and (*name of entity*) that is privileged and confidential, and we expressly reserve all rights with respect to disclosures to third parties. Accordingly, we request confidential treatment under the Freedom of Information Act or similar laws and regulations when requests are made for the attest documentation or

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[7] If the practitioner is not required by law, regulation, or engagement contract to provide a regulator access to the attest documentation but otherwise intends to provide such access (see Interpretation No. 1, "Providing Access to or Copies of Audit Documentation to a Regulator," of AU-C section 230, *Audit Documentation* [AU-C sec. 9230 par. .11–.15]), the letter should include a statement that: "Management of (*name of entity*) has authorized us to provide you access to our attest documentation for (*state purpose*)." [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

[8] Refer to footnote 6.

[9] Refer to footnote 6.

information contained therein or any documents created by the (*name of regulatory agency*) containing information derived there from. We further request that written notice be given to our firm before distribution of the information in the attest documentation (or copies thereof) to others, including other governmental agencies, except when such distribution is required by law or regulation.[10]

[*If it is expected that copies will be requested, add the following*:

Any copies of our attest documentation we agree to provide you will contain a legend "Confidential Treatment Requested by (*name of practitioner, address, telephone number*)."]

[*Firm signature*]

.46 Example letter for agreed-upon procedures engagements:

Illustrative Letter to Regulator[11]

[*Date*]

[*Name and Address of Regulatory Agency*]

Your representatives have requested access to our attest documentation in connection with our engagement to perform agreed-upon procedures on (*identify the subject matter or management's assertion*). It is our understanding that the purpose of your request is (*state purpose:* for example, "to facilitate your regulatory examinations").[12]

Our agreed-upon procedures engagement was conducted in accordance with attestation standards[13] established by the American Institute of Certified Public Accountants. Under these standards, we have the responsibility to perform the agreed-upon procedures to provide a reasonable basis for the findings expressed in our report. We were not engaged to, and did not, perform an examination, the objective of which would be to form an opinion on (*identify the subject matter or management's assertion*). Our engagement is subject to the inherent risk that material misstatement of (*identify the subject matter or management's assertion*), if it exists, would not be detected. (*The practitioner may add the following:* "In addition, our engagement does not address the possibility that material misstatement of (*identify the subject matter or management's assertion*) may occur in the future.") The procedures that we performed were limited to those agreed to by the specified users, and the sufficiency of these procedures is solely the responsibility of the specified users of the report. Further, our engagement does not provide a legal determination on (*name of entity*)'s compliance with specified requirements.

The attest documentation was prepared to document agreed-upon procedures applied, information obtained, and findings reached in the engagement. Accordingly, we make no representation, for your purposes, as to the sufficiency

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[10] This illustrative paragraph may not in and of itself be sufficient to gain confidential treatment under the rules and regulations of certain regulatory agencies. The practitioner should consider tailoring this paragraph to the circumstances after consulting the regulations of each applicable regulatory agency and, if necessary, consult with legal counsel regarding the specific procedures and requirements necessary to gain confidential treatment.

[11] The practitioner should appropriately modify this letter when the engagement has been conducted in accordance with the SSAEs and also in accordance with additional attest requirements specified by a regulatory agency (for example, the requirements specified in *Government Auditing Standards* issued by the Comptroller General of the United States).

[12] If the practitioner is not required by law, regulation or engagement contract to provide a regulator access to the attest documentation but otherwise intends to provide such access (see Interpretation No. 1 of AU-C section 230) the letter should include a statement that: "Management of (*name of entity*) has authorized us to provide you access to our attest documentation for (*state purpose*)." [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

[13] Refer to footnote 6.

or appropriateness of the information in our attest documentation. In addition, any notations, comments, and individual findings appearing on any of the attest documentation should not be read as an opinion on management's assertion or the related subject matter, or any part thereof.

Our engagement was performed for the purpose stated above and was not performed in contemplation of your (*state purpose*: for example, "regulatory examination"). Therefore, items of possible interest to you may not have been specifically addressed. Accordingly, our engagement, and the attest documentation prepared in connection therewith, should not supplant other inquiries and procedures that should be undertaken by the (*name of regulatory agency*) for the purpose of monitoring and regulating (*name of client*). In addition, we have not performed any procedures since the date of our report with respect to the subject matter or management's assertion related thereto, and significant events or circumstances may have occurred since that date.

The attest documentation constitutes and reflects procedures performed or information obtained by us in the course of our engagement. The documents contain trade secrets and confidential commercial and financial information of our firm and (*name of client*) that is privileged and confidential, and we expressly reserve all rights with respect to disclosures to third parties. Accordingly, we request confidential treatment under the Freedom of Information Act or similar laws and regulations when requests are made for the attest documentation or information contained therein or any documents created by the (*name of regulatory agency*) containing information derived therefrom. We further request that written notice be given to our firm before distribution of the information in the attest documentation (or copies thereof) to others, including other governmental agencies, except when such distribution is required by law or regulation.[14]

[*If it is expected that copies will be requested, add the following:*

Any copies of our attest documentation we agree to provide you will contain a legend "Confidential Treatment Requested by (*name of practitioner, address, telephone number*)."]

[*Firm signature*]

[Issue Date: May 1996; Revised: January 2001; January 2002; Revised: December 2012.]

5. Attest Engagements on Financial Information[15] Included in eXtensible Business Reporting Language Instance Documents

.47 *Question*—What is eXtensible Business Reporting Language (XBRL) and an XBRL Instance Document?

.48 *Interpretation*—XBRL, the business reporting aspect of the Extensible Markup Language (XML), is a freely licensable open technology standard, which makes it possible to store and transfer data along with the complex hierarchies, data processing rules, and descriptions that enable analysis and

[14] This illustrative paragraph may not in and of itself be sufficient to gain confidential treatment under the rules and regulations of certain regulatory agencies. The practitioner should consider tailoring this paragraph to the circumstances after consulting the regulations of each applicable regulatory agency and, if necessary, consult with legal counsel regarding the specific procedures and requirements necessary to gain confidential treatment.

[15] Financial information includes data presented in audited or reviewed financial statements or other financial information (for example, management discussion and analysis).

distribution.[16] An entity may make its financial information available in the form of an XBRL Instance Document (instance document). An *instance document* is essentially a machine-readable format of financial information (that is, a computer can read the data, search for information, or perform calculations). Through the XBRL tagging process, a mapping of the financial information is created that enables a user to extract specific information, facilitating analysis. For example, XBRL would enable a user to use a software tool to automatically extract certain financial line items and automatically import those amounts into a worksheet calculating financial ratios.

.49 The instance document consists of various data points and their corresponding XBRL tags (that describe the financial information) and may include references to other items such as a PDF (Adobe Acrobat) version of financial information. Hence, an instance document is a stand-alone document that may be published using a website, e-mail, and other electronic distribution means.

.50 *Question*—What are the practitioner's considerations when the practitioner has been engaged to examine and report on whether the instance document accurately reflects the financial information?

.51 *Interpretation*—The third general attestation standard states that the practitioner shall perform the engagement only if he or she has reason to believe that the subject matter is capable of evaluation against criteria that are suitable and available to users. Two related criteria, XBRL taxonomies and XBRL International Technical Specifications, meet the available and suitable attributes under the attestation standards because a panel of experts developed the criteria and followed due process procedures that included exposure of the proposed criteria for public comment. The entity has the ability to extend the XBRL taxonomy by creating its own entity extension taxonomy. The entity may also create one or more custom entity taxonomies (for example, for a unique industry that is not yet represented by an XBRL taxonomy). Because neither the XBRL entity extension nor the custom taxonomy typically undergoes due process procedures when developed, the practitioner should evaluate whether the XBRL entity extension or custom taxonomy represents suitable and available criteria as described in paragraphs .24–.34 of section 101.

.52 The practitioner should perform procedures he or she believes are necessary to obtain sufficient evidential matter to form an opinion. Example procedures the practitioner should consider performing include the following:

- Compare the rendered[17] instance document to the financial information.
- Trace and agree the instance document's tagged information to the financial information.
- Test that the financial information is appropriately tagged and included in the instance document.
- Test for consistency of tagging (for example, an entity may use one taxonomy tag for one year and then switch to a different tag for the same financial information the following year. In this case, the financial information for both years should use the same tag).

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[16] The eXtensible Business Reporting Language (XBRL) tags and their relationship to other XBRL tags are represented in a taxonomy. The XBRL taxonomy is needed for a full rendering of the XBRL Instance Document.

[17] A rendered instance document converts the machine-readable format to a human readable version through a software tool.

- Test that the entity extension or custom taxonomy meets the XBRL International Technical Specification (for example, through the use of a validation tool).

.53 When the client is the responsible party, the client will provide the practitioner with a written assertion regarding the subject matter. An example of a written assertion follows:

> We assert that the accompanying XBRL Instance Document accurately reflects the data presented in the financial statements of XYZ Company as of December 31, 20XX, and for the year then ended in conformity with [*identify the criteria—for example, specify XBRL taxonomy, such as "XBRL U.S. Consumer and Industrial Taxonomy," and where applicable, the company extension taxonomy, such as "XYZ Company's extension taxonomy" and the XBRL International Technical Specifications (specify version)*].

.54 The practitioner should identify in his or her report whether the underlying financial information has been audited or reviewed, and should refer to the report of such audit or review.[18] If the underlying information has not been audited or reviewed, the practitioner should disclaim an opinion on the underlying information. Any information in the Instance Document that is not covered by the practitioner's report should clearly be identified as such.

.55 Report Examples

Example 1: Reporting on the Subject Matter

<u>Independent Accountant's Report</u>

We have examined the accompanying XBRL Instance Document of XYZ Company, which reflects the data presented in the financial statements of XYZ Company as of December 31, 20XX, and for the year then ended [*optional to include the location of the financial statements, such as "included in the Company's Form 10-K for the year ended December 31, 20XX"*]. XYZ Company's management is responsible for the XBRL Instance Document. Our responsibility is to express an opinion based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence supporting the XBRL Instance Document and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

In our opinion, the XBRL Instance Document of XYZ Company referred to above accurately reflects, in all material respects, the data presented in the financial statements in conformity with [*identify the criteria—for example, specific XBRL taxonomy, such as the "XBRL U.S. Consumer and Industrial Taxonomy," and where applicable, the company extension taxonomy, such as "XYZ Company's extension taxonomy," and the XBRL International Technical Specifications 2.0*].

We have also audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of XYZ Company as of December 31, 20XX, and for the year then ended, and in our report dated

[18] When no audit or review report has been issued, no reference to a report is required.

[*Month*] XX, 20XX, we expressed an unqualified opinion on those financial statements.[19, 20]

[*Signature*]

[*Date*]

Example 2: Reporting on Management's Assertions

Independent Accountant's Report

We have examined management's assertion that [*identify the assertion—for example, the accompanying XBRL Instance Document accurately reflects the data presented in the financial statements of XYZ Company as of December 31, 20XX, and for the year then ended in conformity with (identify the criteria—for example, specific XBRL taxonomy, such as the "XBRL U.S. Consumer and Industrial Taxonomy," and where applicable, the company extension taxonomy, such as "XYZ Company's extension taxonomy," and the XBRL International Technical Specifications 2.0)*]. XYZ Company's management is responsible for the assertion. Our responsibility is to express an opinion on the assertion based on our examination.

We have also audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of XYZ Company, which comprise the balance sheet as of December 31, 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 report dated [*Month*] XX, 20XX, we expressed an unmodified opinion on those financial statements.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence supporting the XBRL Instance Document and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

In our opinion, management's assertion referred to above is fairly stated, in all material respects, in conformity with [*identify the criteria—for example, specific XBRL taxonomy, such as the "XBRL U.S. Consumer and Industrial Taxonomy," and where applicable, the company extension taxonomy, such as "XYZ Company's extension taxonomy," and the XBRL International Technical Specifications 2.0*].

[*Signature*]

[*Date*]

[Issue Date: September 2003; Revised: December 2012.]

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[19] If the financial statements have been reviewed, the sentence would read: "We have also reviewed, in accordance with [*standards established by the American Institute of Certified Public Accountants*] [*Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants*], the financial statements of XYZ Company as of March 31, 20XX, and for the three months then ended, the objective of which was the expression of limited assurance on such financial statements, and issued our report thereon dated [*Month*] XX, 20XX, [*describe any modifications of such report*]."

If the financial information has not been audited or reviewed, no reference to a report is required. The sentence would read: "We were not engaged to and did not conduct an audit or review of the [*identify information*], the objectives of which would have been the expression of an opinion or limited assurance on such [*identify information*]. Accordingly, we do not express an opinion or any other assurance on [*it*] [*them*]."

[20] If the audit opinion on the related financial statements is other than unqualified, the practitioner should disclose that fact, and any substantive reasons therefore.

6. Reporting on Attestation Engagements Performed in Accordance With *Government Auditing Standards*[21]

.56 *Question*—Chapter 5, "Standards for Attestation Engagements," of the 2011 revision of *Government Auditing Standards* (commonly referred to as the Yellow Book) sets forth additional fieldwork and reporting standards for attestation engagements performed pursuant to generally accepted government auditing standards (GAGAS). Practitioners performing attestation engagements under GAGAS are also required to follow the general standards set forth in chapter 3, "General Standards," of the Yellow Book, as well as the guidance and requirements in chapters 1, "Government Auditing: Foundation and Ethical Principles," and 2, "Standards for Use and Application of GAGAS." For examination attestation engagements performed pursuant to GAGAS, paragraph 5.18 of the Yellow Book prescribes additional reporting standards[22] that go beyond the standards of reporting set forth in paragraphs .63–.90 of section 101. When a practitioner performs an attestation examination in accordance with GAGAS, how should the report be modified?

.57 *Interpretation*—The practitioner should modify the scope paragraph of the attestation report to indicate that the examination or review was "conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States."

.58 Additionally, GAGAS require the practitioner's attestation report to disclose any matters (often referred to as findings) that are set forth in paragraphs 5.20–.26 of the revised Yellow Book. Paragraphs 5.27–.28 of the revised Yellow Book set forth the presentation requirements that the practitioner should use, to the extent possible, in reporting a finding. The following illustration is a standard examination report modified to make reference to a schedule of findings when any of the matters set forth in paragraphs 5.20–.26 have been identified. This report pertains to subject matter for which suitable criteria exist and are available to all users through inclusion in a clear manner in the presentation of the subject matter. A written assertion has been obtained from the responsible party. Although the following illustrative report modifications would comply with the Yellow Book requirement, this illustration is not intended to preclude a practitioner from complying with these additional Yellow Book reporting requirements in other ways. In this illustrative report, the practitioner is reporting on the subject matter.

Independent Accountant's Report

We have examined [*identify the subject matter—for example, the accompanying schedule of performance measures of XYZ Agency for the year ended December*

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[21] Although separate interpretations for other AT sections have not been issued to deal with attestation engagements performed in accordance with *Government Auditing Standards*, a practitioner may use this guidance to help him or her appropriately modify an attest report pursuant to other AT sections.

[22] Paragraph 5.18 of the Yellow Book sets forth the additional reporting requirements: (*a*) reporting auditors' compliance with generally accepted government auditing standards, (*b*) reporting deficiencies in internal control, fraud, noncompliance with provisions of laws, regulations, contracts, and grant agreements, and abuse, (*c*) reporting views of responsible officials, (*d*) reporting confidential or sensitive information, and (*e*) distributing reports. [Footnote revised, January 2008, to reflect conforming changes necessary due to the issuance of the 2007 revised *Government Auditing Standards*. Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of the 2011 revision of *Government Auditing Standards*.]

31, 20XX].[23] XYZ Agency's management is responsible for the [*identify the subject matter—for example, schedule of performance measures*]. Our responsibility is to express an opinion based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included examining, on a test basis, evidence supporting [*identify the subject matter—for example, XYZ Agency's schedule of performance measures*] and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

[*Additional paragraph(s) may be added to emphasize certain matters relating to the attest engagement or the subject matter*.]

In our opinion, the schedule referred to above presents, in all material respects, [*identify the subject matter—for example, the performance measures of XYZ Agency for the year ended December 31, 20XX*], in conformity with [*identify criteria—for example, the criteria set forth in Note 1*].

[*When any of the matters set forth in paragraphs 5.20–.26 of the Yellow Book have been identified the following paragraph would be added*.]

In accordance with *Government Auditing Standards*, we are required to report all deficiencies that are considered to be significant deficiencies or material weaknesses in internal control; fraud and noncompliance with provisions of laws or regulations that have a material effect on [*identify the subject matter—for example, XYZ Agency's schedule of performance measures*]; and any other instances that warrant the attention of those charged with governance; noncompliance with provisions of contracts or grant agreements, and abuse that has a material effect on the subject matter.[24] We are also required to obtain and report the views of responsible officials concerning the findings, conclusions, and recommendations, as well as any planned corrective actions. We performed our examination to express an opinion on whether [*identify the subject matter—for example, XYZ Agency's schedule of performance measures*] is presented in accordance with the criteria described above and not for the purpose of expressing an opinion on the internal control over [*identify the subject matter—for example, reporting of performance measures*] or on compliance and other matters; accordingly, we express no such opinions. Our examination disclosed certain findings that are required to be reported under *Government Auditing Standards* and

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[23] If the practitioner is reporting on an assertion about the subject matter, the practitioner would identify the assertion rather than the subject matter, for example, "management's assertion that the accompanying schedule presents the performance measures of XYZ Agency for the year ended December 31, 20XX in conformity with the criteria in Note 1." [Footnote added, December 2012, to reflect conforming changes necessary due to the issuance of the 2011 revision of *Government Auditing Standards*.]

[24] Note that paragraph 5.25 of *Government Auditing Standards* states that when auditors detect instances of noncompliance with provisions of contracts or grant agreements, or abuse that have an effect on the subject matter or an assertion about the subject matter that is less than material but warrant the attention of those charged with governance, they should communicate those findings in writing to entity officials. When auditors detect any instances of fraud, noncompliance with provisions of laws, regulations, contracts, or grant agreements, or abuse that do not warrant the attention of those charged with governance, the auditors' determination of whether and how to communicate such instances to audited entity officials is a matter of professional judgment. [Footnote added, January 2008, to reflect conforming changes necessary due to the issuance of the 2007 revised *Government Auditing Standards*. Footnote renumbered and revised, December 2012, to reflect conforming changes necessary due to the issuance of the 2011 revision of *Government Auditing Standards*.]

those findings, along with the views of responsible officials, are described in the attached Schedule of Findings.[25]

[*Signature*]

[*Date*]

[25] [Footnote renumbered and deleted to reflect conforming changes necessary due to the issuance of the 2007 revised *Government Auditing Standards*. Footnote renumbered, December 2012, to reflect conforming changes necessary due to the issuance of the 2011 revision of *Government Auditing Standards*.]

Illustrative Schedule of Findings

XYZ Agency
Schedule of Findings[26]
Year Ended December 31, 20XX

Finding No. 1

Criteria

Condition

Cause

Effect or Potential Effect

Management's Response

Finding No. 2

Criteria

Condition

Cause

Effect or Potential Effect

Management's Response

[Issue Date: December 2004; Revised: January 2008;
Revised: December 2012.]

[26] Refer to paragraphs 5.11–.15 of the Yellow Book regarding the content of the schedule of findings. [Footnote renumbered and revised: January 2008, to reflect conforming changes necessary due to the issuance of the 2007 revised *Government Auditing Standards*. Footnote renumbered and revised, December 2012, to reflect conforming changes necessary due to the issuance of the 2011 revision of *Government Auditing Standards*.]

7. Reporting on the Design of Internal Control

.59 *Question*—A practitioner may be asked to report on the suitability[27] of the design of an entity's internal control over financial reporting (internal control) for preventing or detecting and correcting material misstatements of the entity's financial statements on a timely basis. Such requests may be made by, for example,

- an entity applying for a government grant or contract that is required to submit a written preaward survey by management about the suitability of the design of the entity's internal control or a portion of the entity's internal control, together with a practitioner's report thereon.
- a new casino applying for a license to operate that is required by a regulatory agency to submit a practitioner's report on whether the entity's internal control *that it plans to implement* is suitably designed to provide reasonable assurance that the control objectives specified in the regulatory agency's regulations would be achieved. (In this situation the casino would not yet have begun operations, and audited financial statements or financial data relevant to the period covered by the engagement may not exist.)

May a practitioner report on the suitability of the design of an entity's internal control based on the risk assessment procedures the auditor performs to obtain a sufficient understanding of the entity and its environment, including its internal control, in an audit of the entity's financial statements?

.60 *Interpretation*—No. In a financial statement audit, the purpose of the auditor's understanding of the entity and its environment, including its internal control, is to enable the auditor to assess the risk of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures. The understanding obtained in a financial statement audit does not provide the practitioner with a sufficient basis to report on the suitability of the design of an entity's internal control or any portion thereof.

.61 *Question*—How may a practitioner report on the suitability of the design of an entity's internal control or a portion thereof?

.62 *Interpretation*—The practitioner may perform an examination under section 101, or apply agreed-upon procedures under section 201, to management's written assertion about the suitability of the design of the entity's internal control. Footnote 4 of section 501, *An Examination of an Entity's Internal Control Over Financial Reporting That is Integrated With an Audit of Its Financial Statements*, states that although section 501 does not directly apply when an auditor is engaged to examine the suitability of design of an entity's internal control, it may be useful in planning and performing such engagements. Paragraphs .57–.59 of section 501 discuss how the auditor evaluates the design effectiveness of controls.

.63 When the engagement involves the application of agreed-upon procedures to a written assertion about the suitability of the design of an entity's internal control over compliance with specified requirements, the practitioner should also follow the provisions of paragraphs .09 and .11–.29 of section 601.

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[27] In this interpretation, the *suitability of the design of internal control* means the same thing as the *design effectiveness of an entity's internal control.* [Footnote renumbered, December 2012, to reflect conforming changes necessary due to the issuance of the 2011 revision of *Government Auditing Standards*.]

.64 The following is an illustrative report a practitioner may issue when reporting on the suitability of the design of an entity's internal control that has been implemented. The report may be modified, as appropriate, to fit the particular circumstances.

<u>Independent Accountant's Report</u>

[*Introductory paragraph*]

We have examined the suitability of the design of W Company's internal control over financial reporting to prevent or detect and correct material misstatements in its financial statements on a timely basis as of December 31, 20XX, based on [*identify criteria*].[28] W Company's management is responsible for the suitable design of internal control over financial reporting. Our responsibility is to express an opinion on the design of internal control based on our examination.

[*Scope paragraph*]

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included obtaining an understanding of internal control over financial reporting, evaluating the design of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. We were not engaged to examine and report on the operating effectiveness of W Company's internal control over financial reporting as of December 31, 20XX, and, accordingly, we express no opinion on operating effectiveness.

[*Inherent limitations paragraph*]

Because of its inherent limitations, internal control over financial reporting may not prevent or detect and correct misstatements. Also, projections of any evaluation 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 paragraph*]

In our opinion, W Company's internal control over financial reporting was suitably designed, in all material respects, to prevent or detect and correct material misstatements in the financial statements on a timely basis as of December 31, 20XX, based on [*identify criteria*].

[*Signature*]

[*Date*]

.65 When reporting on the suitability of the design of an entity's internal control that has not yet been implemented, the practitioner would be unable to confirm that the controls have been implemented and should disclose that information in the practitioner's report. In those circumstances, the practitioner should modify (1) the scope paragraph of the illustrative report in paragraph .64 to inform readers that the controls identified in the report have not yet been implemented and (2) the inherent limitations paragraph to reflect the related risk. Following are modified illustrative report paragraphs for use when controls have not yet been implemented. (New language is shown in boldface italics. Deleted language is shown in strikethrough.)

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[28] This report assumes that the control criteria are both suitable and available to users as discussed in paragraphs .23–.33 of section 101. Therefore, the use of this report is not restricted. [Footnote renumbered, December 2012, to reflect conforming changes necessary due to the issuance of the 2011 revision of *Government Auditing Standards*.]

> Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included obtaining an understanding of internal control over financial reporting, evaluating the design of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. ***Because operations had not begun as of December 31, 20XX, we could not confirm that the specified controls were implemented. Accordingly, our report solely addresses the suitability of the design of the Company's internal control and does not address whether the controls were implemented. Furthermore, because the specified controls have not yet been implemented, we were unable to test, and did not test,*** the operating effectiveness of W Company's internal control over financial reporting as of December 31, 20XX, and, accordingly, we express no opinion on operating effectiveness.
>
> [*Inherent limitations paragraph*]
>
> Because of its inherent limitations, internal control over financial reporting may not prevent or detect and correct misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls ***may not be implemented as intended when operations begin or*** may become inadequate because of changes in conditions~~, or that the degree of compliance with the policies or procedures may deteriorate~~.

.66 *Question*—A practitioner may be asked to sign a prescribed form developed by the party to whom the form is to be submitted regarding the design of an entity's internal control. What are the practitioner's responsibilities when requested to sign such a form if it includes language that is not consistent with the practitioner's function or responsibility or with the reporting requirements of professional standards?

.67 *Interpretation*—Paragraphs .22–.23 of AU-C section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, address such situations in the context of an audit of financial statements and indicate that the auditor should either reword the prescribed form of report or attach an appropriately worded separate report that conforms with the auditor's function or responsibility and professional standards. When reporting on the suitability of the design of an entity's internal control under section 101, the practitioner's report should contain all of the elements in either paragraphs .85 or .86, as applicable, which can be accomplished by either rewording the prescribed form of report or attaching an appropriately worded separate report in place of the prescribed form.

.68 *Question*—An entity may be required to submit a practitioner's report about an entity's *ability* to establish suitably designed internal control (or its assertion thereon). May a practitioner issue such a report based on (*a*) the risk assessment procedures related to existing internal control that the auditor performs in an audit of an entity's financial statements or (*b*) the performance of an attest engagement?

.69 *Interpretation*—No. Neither the risk assessment procedures the auditor performs in an audit of an entity's financial statements nor the performance of an attest engagement provide the practitioner with a basis for issuing a report on the *ability* of an entity to establish suitably designed internal control. There are no suitable criteria for evaluating an entity's ability to establish suitably designed internal control. The requesting party may be willing to accept a report of the practitioner on a consulting service. The practitioner may include in the consulting service report *a*. a statement that the practitioner is unable to perform an attest engagement that addresses the entity's ability to establish suitably designed internal control because there are no suitable criteria for evaluating the entity's ability to do so;

b. a description of the nature and scope of the practitioner's services; and

c. the practitioner's findings.

The practitioner may refer to the guidance in CS section 100, *Consulting Services*: *Definitions and Standards*.

[Issue Date: December 2008; Revised: December 2012.]

8. Including a Description of Tests of Controls or Other Procedures, and the Results Thereof, in an Examination Report

.70 *Question*—Section 801, *Reporting on Controls at a Service Organization*, addresses examination engagements undertaken by a service auditor to report on controls at organizations that provide services to user entities when those controls are likely to be relevant to user entities' internal control over financial reporting (ICFR). For a type 2 report resulting from such an examination engagement, section 801 provides for a separate section of the report that includes a description of the service auditor's tests of controls likely to be relevant to user entities' ICFR and the results of those tests. This information is intended for user auditors who may need detailed information about the results of such tests of controls to determine how the results affect a particular user entity's financial statements.

.71 Paragraph .02 of section 801 refers the practitioner to section 101, when a practitioner is engaged to examine and report on controls at a service organization other than those likely to be relevant to user entities' ICFR (for example, controls at a service provider that are relevant to user entities' compliance with laws or regulations or controls at a service provider that are relevant to the privacy of user entities' information).[29] If a practitioner performs an examination engagement under section 101, may the practitioner's examination report include, in a separate section, a description of tests of controls or other procedures performed in support of the practitioner's opinion resulting from such an engagement?

.72 *Interpretation*—Nothing in section 101 precludes a practitioner from including in a separate section of his or her examination report a description of tests of controls or other procedures performed and the results thereof. However, in some cases, such a description may overshadow the practitioner's overall opinion or may cause report users to misunderstand the opinion. Therefore, the circumstances of the particular engagement are relevant to the practitioner's consideration regarding whether to include a description of tests of controls or other procedures performed, and the results thereof, in a separate section of the practitioner's examination report. In determining whether to include such a description in the practitioner's examination report, the following considerations are relevant:

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[29] As indicated in paragraph A2 of section 801, *Reporting on Controls at a Service Organization*, paragraph .02 of section 801 is not intended to permit a report that combines reporting on a service organization's controls likely to be relevant to user entities' internal control over financial reporting (ICFR) with reporting on controls that are not likely to be relevant to user entities' ICFR. [Footnote renumbered, December 2012, to reflect conforming changes necessary due to the issuance of the 2011 revision of *Government Auditing Standards*.]

- Whether there has been a request for such information and whether the specified parties making the request have an appropriate business need or reasonable basis for requesting the information (for example, the specified parties are required to maintain and monitor controls that either encompass or are dependent on controls that are the subject of the examination and, therefore, need information about the tests of controls to enable them to have a basis for concluding that they have met the requirements applicable to them)
- Whether the specified parties have an understanding of the nature and subject matter of the engagement and experience in using the information in such reports
- Whether including such a description in the examination report is likely to cause report users to misunderstand the opinion
- Whether the practitioner's tests of controls or other procedures performed directly relate to the subject matter of the engagement

Paragraph .79 of section 101 states, "The need for restriction on the use of a report may result from a number of circumstances, including the purpose of the report, the criteria used in preparation of the subject matter, the extent to which the procedures performed are known or understood, and the potential for the report to be misunderstood when taken out of the context in which it was intended to be used." The addition of a description of tests of controls or other procedures performed, and the results thereof, in a separate section of an examination report may increase the need for use of the report to be restricted to specified parties.

[Issue Date: July 2010.]

AT Section 201

Agreed-Upon Procedures Engagements

Source: SSAE No. 10; SSAE No. 11.

Effective when the subject matter or assertion is as of or for a period ending on or after June 1, 2001, unless otherwise indicated.

Introduction and Applicability

.01 This section sets forth attestation standards and provides guidance to a practitioner concerning performance and reporting in all agreed-upon procedures engagements, except as noted in paragraph .02. A practitioner also should refer to the following sections of this Statement on Standards for Attestation Engagements (SSAE), which provide additional guidance for certain types of agreed-upon procedures engagements:

a. Section 301, *Financial Forecasts and Projections*

b. Section 601, *Compliance Attestation*

.02 This section does not apply to the following:[1]

a. Situations in which an auditor reports on specified compliance requirements based solely on an audit of financial statements, as addressed in AU-C section 806, *Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements*

b. Engagements for which the objective is to report in accordance with AU-C section 935, *Compliance Audits*, unless the terms of the engagement specify that the engagement be performed pursuant to SSAEs

c. Engagements covered by AU-C section 920, *Letters for Underwriters and Certain Other Requesting Parties*

d. Certain professional services that would not be considered as falling under this section as described in paragraph .04 of section 101, *Attest Engagements*

[Revised, December 2010, to reflect conforming changes necessary due to the issuance of SAS No. 117. Revised, August 2011, to reflect conforming changes necessary due to the issuance of SSAE No. 16. Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Agreed-Upon Procedures Engagements

.03 An agreed-upon procedures engagement is one in which a practitioner is engaged by a client to issue a report of findings based on specific procedures performed on subject matter. The client engages the practitioner to assist specified parties in evaluating subject matter or an assertion as a result of a need

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[1] Interpretation No. 2, "Responding to Requests for Reports on Matters Relating to Solvency," of section 101, *Attest Engagements* (sec. 9101 par. .23–.33), prohibits the performance of any attest engagements concerning matters of solvency or insolvency.

or needs of the specified parties.[2] Because the specified parties require that findings be independently derived, the services of a practitioner are obtained to perform procedures and report his or her findings. The specified parties and the practitioner agree upon the procedures to be performed by the practitioner that the specified parties believe are appropriate. Because the needs of the specified parties may vary widely, the nature, timing, and extent of the agreed-upon procedures may vary as well; consequently, the specified parties assume responsibility for the sufficiency of the procedures since they best understand their own needs. In an engagement performed under this section, the practitioner does not perform an examination or a review, as discussed in section 101, and does not provide an opinion or negative assurance.[3] (See paragraph .24.) Instead, the practitioner's report on agreed-upon procedures should be in the form of procedures and findings. (See paragraph .31.)

.04 As a consequence of the role of the specified parties in agreeing upon the procedures performed or to be performed, a practitioner's report on such engagements should clearly indicate that its use is restricted to those specified parties.[4] Those specified parties, including the client, are hereinafter referred to as *specified parties*.

Standards

.05 The general, fieldwork, and reporting standards for attestation engagements as established in section 50, *SSAE Hierarchy*, together with interpretive guidance regarding their application as addressed throughout this section, should be followed by the practitioner in performing and reporting on agreed-upon procedures engagements. [Revised, November 2006, to reflect conforming changes necessary due to the issuance of SSAE No. 14.]

Conditions for Engagement Performance

.06 The practitioner may perform an agreed-upon procedures attest engagement provided that—

a. The practitioner is independent.

b. One of the following conditions is met.

   (1) The party wishing to engage the practitioner is responsible for the subject matter, or has a reasonable basis for providing a written assertion about the subject matter when the nature of the subject matter is such that a responsible party does not otherwise exist.

   (2) The party wishing to engage the practitioner is not responsible for the subject matter but is able to provide the practitioner, or have a third party who is responsible for the subject matter provide the practitioner with evidence of the third party's responsibility for the subject matter.

c. The practitioner and the specified parties agree upon the procedures performed or to be performed by the practitioner.

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[2] See paragraphs .08–.09 for a discussion of subject matter and assertion.

[3] For guidance on expressing an opinion on specified elements, accounts, or items of a financial statement based on an audit, see AU-C section 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

[4] See paragraphs .78–.83 of section 101 for additional guidance regarding restricted-use reports.

d. The specified parties take responsibility for the sufficiency of the agreed-upon procedures for their purposes.

e. The specific subject matter to which the procedures are to be applied is subject to reasonably consistent measurement.

f. Criteria to be used in the determination of findings are agreed upon between the practitioner and the specified parties.

g. The procedures to be applied to the specific subject matter are expected to result in reasonably consistent findings using the criteria.

h. Evidential matter related to the specific subject matter to which the procedures are applied is expected to exist to provide a reasonable basis for expressing the findings in the practitioner's report.

i. Where applicable, the practitioner and the specified parties agree on any materiality limits for reporting purposes. (See paragraph .25.)

j. Use of the report is restricted to the specified parties.

k. For agreed-upon procedures engagements on prospective financial information, the prospective financial statements include a summary of significant assumptions. (See paragraph .52 of section 301.)

Agreement on and Sufficiency of Procedures

.07 To satisfy the requirements that the practitioner and the specified parties agree upon the procedures performed or to be performed and that the specified parties take responsibility for the sufficiency of the agreed-upon procedures for their purposes, ordinarily the practitioner should communicate directly with and obtain affirmative acknowledgment from each of the specified parties. For example, this may be accomplished by meeting with the specified parties or by distributing a draft of the anticipated report or a copy of an engagement letter to the specified parties and obtaining their agreement. If the practitioner is not able to communicate directly with all of the specified parties, the practitioner may satisfy these requirements by applying any one or more of the following or similar procedures.

- Compare the procedures to be applied to written requirements of the specified parties.
- Discuss the procedures to be applied with appropriate representatives of the specified parties involved.
- Review relevant contracts with or correspondence from the specified parties.

The practitioner should not report on an engagement when specified parties do not agree upon the procedures performed or to be performed and do not take responsibility for the sufficiency of the procedures for their purposes. (See paragraph .36 for guidance on satisfying these requirements when the practitioner is requested to add other parties as specified parties after the date of completion of the agreed-upon procedures.)

Subject Matter and Related Assertions

.08 The subject matter of an agreed-upon procedures engagement may take many different forms and may be at a point in time or covering a period of time. In an agreed-upon procedures engagement, it is the specific subject matter to which the agreed-upon procedures are to be applied using the criteria selected. Even though the procedures are agreed upon between the practitioner and the specified parties, the subject matter and the criteria must meet the conditions set forth in the third general standard. (See paragraphs .23–.24 of section 101.) The criteria against which the specific subject matter needs to be measured may be recited within the procedures enumerated or referred to in the practitioner's report.

.09 An assertion is any declaration or set of declarations about whether the subject matter is based on or in conformity with the criteria selected. A written assertion is generally not required in an agreed-upon procedures engagement unless specifically required by another attest standard (for example, see paragraph .11 of section 601). If, however, the practitioner requests the responsible party to provide an assertion, the assertion may be presented in a representation letter or another written communication from the responsible party, such as in a statement, narrative description, or schedule appropriately identifying what is being presented and the point in time or the period of time covered.

Establishing an Understanding With the Client

.10 The practitioner should establish an understanding with the client regarding the services to be performed. When the practitioner documents the understanding through a written communication with the client (an *engagement letter*), such communication should be addressed to the client, and in some circumstances also to all specified parties. Matters that might be included in such an understanding include the following:

- The nature of the engagement
- Identification of the subject matter (or the assertion related thereto), the responsible party, and the criteria to be used
- Identification of specified parties (See paragraph .36.)
- Specified parties' acknowledgment of their responsibility for the sufficiency of the procedures
- Responsibilities of the practitioner (See paragraphs .12–.14 and .40.)
- Reference to attestation standards established by the American Institute of Certified Public Accountants (AICPA)
- Agreement on procedures by enumerating (or referring to) the procedures (See paragraphs .15–.18.)
- Disclaimers expected to be included in the practitioner's report
- Use restrictions
- Assistance to be provided to the practitioner (See paragraphs .22–.23.)
- Involvement of a specialist (See paragraphs .19–.21.)
- Agreed-upon materiality limits (See paragraph .25.)

Nature, Timing, and Extent of Procedures

Responsibility of the Specified Parties

.11 Specified parties are responsible for the sufficiency (nature, timing, and extent) of the agreed-upon procedures because they best understand their own needs. The specified parties assume the risk that such procedures might be insufficient for their purposes. In addition, the specified parties assume the risk that they might misunderstand or otherwise inappropriately use findings properly reported by the practitioner.

Practitioner's Responsibility

.12 The responsibility of the practitioner is to carry out the procedures and report the findings in accordance with the general, fieldwork, and reporting standards as discussed and interpreted in this section. The practitioner assumes the risk that misapplication of the procedures may result in inappropriate findings being reported. Furthermore, the practitioner assumes the risk that appropriate findings may not be reported or may be reported inaccurately. The practitioner's risks can be reduced through adequate planning and supervision and due professional care in performing the procedures, determining the findings, and preparing the report.

.13 The practitioner should have adequate knowledge in the specific subject matter to which the agreed-upon procedures are to be applied. He or she may obtain such knowledge through formal or continuing education, practical experience, or consultation with others.[5]

.14 The practitioner has no responsibility to determine the differences between the agreed-upon procedures to be performed and the procedures that the practitioner would have determined to be necessary had he or she been engaged to perform another form of attest engagement. The procedures that the practitioner agrees to perform pursuant to an agreed-upon procedures engagement may be more or less extensive than the procedures that the practitioner would determine to be necessary had he or she been engaged to perform another form of engagement.

Procedures to Be Performed

.15 The procedures that the practitioner and specified parties agree upon may be as limited or as extensive as the specified parties desire. However, mere reading of an assertion or specified information about the subject matter does not constitute a procedure sufficient to permit a practitioner to report on the results of applying agreed-upon procedures. In some circumstances, the procedures agreed upon evolve or are modified over the course of the engagement. In general, there is flexibility in determining the procedures as long as the specified parties acknowledge responsibility for the sufficiency of such procedures for their purposes. Matters that should be agreed upon include the nature, timing, and extent of the procedures.

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[5] Paragraphs .19–.20 of section 601 provide guidance about obtaining an understanding of certain requirements in an agreed-upon procedures engagement on compliance.

.16 The practitioner should not agree to perform procedures that are overly subjective and thus possibly open to varying interpretations. Terms of uncertain meaning (such as general review, limited review, check, or test) should not be used in describing the procedures unless such terms are defined within the agreed-upon procedures. The practitioner should obtain evidential matter from applying the agreed-upon procedures to provide a reasonable basis for the finding or findings expressed in his or her report, but need not perform additional procedures outside the scope of the engagement to gather additional evidential matter.

.17 Examples of appropriate procedures include the following:

- Execution of a sampling application after agreeing on relevant parameters
- Inspection of specified documents evidencing certain types of transactions or detailed attributes thereof
- Confirmation of specific information with third parties
- Comparison of documents, schedules, or analyses with certain specified attributes
- Performance of specific procedures on work performed by others (including the work of internal auditors—see paragraphs .22–.23)
- Performance of mathematical computations

.18 Examples of inappropriate procedures include the following:

- Mere reading of the work performed by others solely to describe their findings
- Evaluating the competency or objectivity of another party
- Obtaining an understanding about a particular subject
- Interpreting documents outside the scope of the practitioner's professional expertise

Involvement of a Specialist[6]

.19 The practitioner's education and experience enable him or her to be knowledgeable about business matters in general, but he or she is not expected to have the expertise of a person trained for or qualified to engage in the practice of another profession or occupation. In certain circumstances, it may be appropriate to involve a specialist to assist the practitioner in the performance of one or more procedures. The following are examples.

- An attorney might provide assistance concerning the interpretation of legal terminology involving laws, regulations, rules, contracts, or grants.
- A medical specialist might provide assistance in understanding the characteristics of diagnosis codes documented in patient medical records.
- An environmental engineer might provide assistance in interpreting environmental remedial action regulatory directives that may affect

[6] A *specialist* is a person (or firm) possessing skill or knowledge in a particular field other than the attest function. As used herein, a specialist does not include a person employed by the practitioner's firm who participates in the attest engagement.

the agreed-upon procedures applied to an environmental liabilities account in a financial statement.

- A geologist might provide assistance in distinguishing between varying physical characteristics of a generic minerals group related to information to which the agreed-upon procedures are applied.

.20 The practitioner and the specified parties should explicitly agree to the involvement of the specialist in assisting a practitioner in the performance of an agreed-upon procedures engagement. This agreement may be reached when obtaining agreement on the procedures performed or to be performed and acknowledgment of responsibility for the sufficiency of the procedures, as discussed in paragraph .07. The practitioner's report should describe the nature of the assistance provided by the specialist.

.21 A practitioner may agree to apply procedures to the report or work product of a specialist that does not constitute assistance by the specialist to the practitioner in an agreed-upon procedures engagement. For example, the practitioner may make reference to information contained in a report of a specialist in describing an agreed-upon procedure. However, it is inappropriate for the practitioner to agree to merely read the specialist's report solely to describe or repeat the findings, or to take responsibility for all or a portion of any procedures performed by a specialist or the specialist's work product.

Internal Auditors and Other Personnel

.22 The agreed-upon procedures to be enumerated or referred to in the practitioner's report are to be performed entirely by the practitioner except as discussed in paragraphs .19–.21.[7] However, internal auditors or other personnel may prepare schedules and accumulate data or provide other information for the practitioner's use in performing the agreed-upon procedures. Also, internal auditors may perform and report separately on procedures that they have carried out. Such procedures may be similar to those that a practitioner may perform under this section.

.23 A practitioner may agree to perform procedures on information documented in the working papers of internal auditors. For example, the practitioner may agree to—

- Repeat all or some of the procedures.
- Determine whether the internal auditors' working papers contain documentation of procedures performed and whether the findings documented in the working papers are presented in a report by the internal auditors.

However, it is inappropriate for the practitioner to—

- Agree to merely read the internal auditors' report solely to describe or repeat their findings.
- Take responsibility for all or a portion of any procedures performed by internal auditors by reporting those findings as the practitioner's own.
- Report in any manner that implies shared responsibility for the procedures with the internal auditors.

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[7] AU-C section 610, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*, does not apply to agreed-upon procedures engagements. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Findings

.24 A practitioner should present the results of applying agreed-upon procedures to specific subject matter in the form of findings. The practitioner should not provide negative assurance about whether the subject matter or the assertion is fairly stated based on the criteria. For example, the practitioner should not include a statement in his or her report that "nothing came to my attention that caused me to believe that the [*identify subject matter*] is not presented based on [or the assertion is not fairly stated based on] [*identify criteria*]."

.25 The practitioner should report all findings from application of the agreed-upon procedures. The concept of materiality does not apply to findings to be reported in an agreed-upon procedures engagement unless the definition of materiality is agreed to by the specified parties. Any agreed-upon materiality limits should be described in the practitioner's report.

.26 The practitioner should avoid vague or ambiguous language in reporting findings. Examples of appropriate and inappropriate descriptions of findings resulting from the application of certain agreed-upon procedures follow.

Procedures Agreed Upon	***Appropriate Description of Findings***	***Inappropriate Description of Findings***
Inspect the shipment dates for a sample (agreed-upon) of specified shipping documents, and determine whether any such dates were subsequent to December 31, 20XX.	No shipment dates shown on the sample of shipping documents were subsequent to December 31, 20XX.	Nothing came to my attention as a result of applying that procedure.
Calculate the number of blocks of streets paved during the year ended September 30, 20XX, shown on contractors' certificates of project completion; compare the resultant number to the number in an identified chart of performance statistics.	The number of blocks of streets paved in the chart of performance statistics was Y blocks more than the number calculated from the contractors' certificates of project completion.	The number of blocks of streets paved approximated the number of blocks included in the chart of performance statistics.
Calculate the rate of return on a specified investment (according to an agreed-upon formula) and verify that the resultant percentage agrees to the percentage in an identified schedule.	No exceptions were found as a result of applying the procedure.	The resultant percentage approximated the predetermined percentage in the identified schedule.

Procedures Agreed Upon	*Appropriate Description of Findings*	*Inappropriate Description of Findings*
Inspect the quality standards classification codes in identified performance test documents for products produced during a specified period; compare such codes to those shown in an identified computer printout.	All classification codes inspected in the identified documents were the same as those shown in the computer printout except for the following: [*List all exceptions.*]	All classification codes appeared to comply with such performance documents.
Trace all outstanding checks appearing on a bank reconciliation as of a certain date to checks cleared in the bank statement of the subsequent month.	All outstanding checks appearing on the bank reconciliation were cleared in the subsequent month's bank statement except for the following: [*List all exceptions.*]	Nothing came to my attention as a result of applying the procedure.
Compare the amounts of the invoices included in the "over ninety days" column shown in an identified schedule of aged accounts receivable of a specific customer as of a certain date to the amount and invoice date shown on the outstanding invoice and determine whether or not the invoice dates precede the date indicated on the schedule by more than ninety days.	All outstanding invoice amounts agreed with the amounts shown on the schedule in the "over ninety days" column, and the dates shown on such invoices preceded the date indicated on the schedule by more than ninety days.	The outstanding invoice amounts agreed within approximation of the amounts shown on the schedule in the "over ninety days" column, and nothing came to our attention that the dates shown on such invoices preceded the date indicated on the schedule by more than ninety days.

Working Papers

[.27–.30] [Paragraphs deleted by the issuance of SSAE No. 11, January 2002.][8–9]

[8–9] [Footnotes deleted by the issuance of SSAE No. 11, January 2002.]

Reporting

Required Elements

.31 The practitioner's report on agreed-upon procedures should be in the form of procedures and findings. The practitioner's report should contain the following elements:

a. A title that includes the word *independent*

b. Identification of the specified parties (See paragraph .36.)

c. Identification of the subject matter[10] (or the written assertion related thereto) and the character of the engagement

d. Identification of the responsible party

e. A statement that the subject matter is the responsibility of the responsible party

f. A statement that the procedures performed were those agreed to by the specified parties identified in the report

g. A statement that the agreed-upon procedures engagement was conducted in accordance with attestation standards established by the AICPA

h. A statement that the sufficiency of the procedures is solely the responsibility of the specified parties and a disclaimer of responsibility for the sufficiency of those procedures

i. A list of the procedures performed (or reference thereto) and related findings (The practitioner should not provide negative assurance—see paragraph .24.)

j. Where applicable, a description of any agreed-upon materiality limits (See paragraph .25.)

k. A statement that the practitioner was not engaged to and did not conduct an examination [11, 12] of the subject matter, the objective of which would be the expression of an opinion, a disclaimer of opinion on the subject matter, and a statement that if the practitioner had performed

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[10] In some agreed-upon procedures engagements, the practitioner may be asked to apply agreed-upon procedures to more than one subject matter or assertion. In these engagements, the practitioner may issue one report that refers to all subject matter covered or assertions presented. (For example, see paragraph .28 of section 601.)

[11] If the practitioner also wishes to refer to a review, alternate wording would be as follows.

> A statement that the practitioner was not engaged to and did not conduct an examination or a review of the subject matter, the objectives of which would be the expression of an opinion or limited assurance, a disclaimer of opinion on the subject matter, and a statement that if the practitioner had performed additional procedures, other matters might have come to his or her attention that would have been reported.

[12] If the subject matter consists of elements, accounts, or items of a financial statement, this statement may be worded as follows.

> We were not engaged to and did not conduct an audit [*or a review*], the objective of which would be the expression of an opinion [*or limited assurance*] on the [*identify elements, accounts, or items of a financial statement*]. Accordingly, we do not express such an opinion [*or limited assurance*].

Alternatively, the wording may be the following.

> These agreed-upon procedures do not constitute an audit [*or a review*] of financial statements or any part thereof, the objective of which is the expression of opinion [or limited assurance] on the financial statements or a part thereof.

additional procedures, other matters might have come to his or her attention that would have been reported[13]

l. A statement of restrictions on the use of the report because it is intended to be used solely by the specified parties[14]

m. Where applicable, reservations or restrictions concerning procedures or findings as discussed in paragraphs .33, .35, and .39–.40

n. For an agreed-upon procedures engagement on prospective financial information, all items included in paragraph .55 of section 301

o. Where applicable, a description of the nature of the assistance provided by a specialist as discussed in paragraphs .19–.21

p. The manual or printed signature of the practitioner's firm

q. The date of the report

Illustrative Report

.32 The following is an illustration of an agreed-upon procedures report.

Independent Accountant's Report
on Applying Agreed-Upon Procedures

To the Audit Committees and Managements of ABC Inc. and XYZ Fund:

We have performed the procedures enumerated below, which were agreed to by the audit committees and managements of ABC Inc. and XYZ Fund, solely to assist you in evaluating the accompanying Statement of Investment Performance Statistics of XYZ Fund (prepared in accordance with the criteria specified therein) for the year ended December 31, 20X1. XYZ Fund's management is responsible for the statement of investment performance statistics. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

[*Include paragraphs to enumerate procedures and findings*.]

We were not engaged to and did not conduct an examination, the objective of which would be the expression of an opinion on the accompanying Statement of Investment Performance Statistics of XYZ Fund. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the audit committees and managements of ABC Inc. and XYZ Fund,[15] and is not intended to be and should not be used by anyone other than these specified parties.

[*Signature*]

[*Date*]

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[13] [Footnote deleted, December 2012, to reflect conforming changes necessary due to the issuance of SSARS No. 19 and SAS Nos. 122–126.]

[14] The purpose of the restriction on the use of the practitioner's report on applying agreed-upon procedures is to restrict its use to only those parties that have agreed upon the procedures performed and taken responsibility for the sufficiency of the procedures. Paragraph .36 describes the process for adding parties who were not originally contemplated in the agreed-upon procedures engagement.

[15] The report may list the specified parties or refer the reader to the specified parties listed elsewhere in the report.

Explanatory Language

.33 The practitioner also may include explanatory language about matters such as the following:

- Disclosure of stipulated facts, assumptions, or interpretations (including the source thereof) used in the application of agreed-upon procedures (For example, see paragraph .26 of section 601.)
- Description of the condition of records, controls, or data to which the procedures were applied
- Explanation that the practitioner has no responsibility to update his or her report
- Explanation of sampling risk

Dating of Report

.34 The date of completion of the agreed-upon procedures should be used as the date of the practitioner's report.

Restrictions on the Performance of Procedures

.35 When circumstances impose restrictions on the performance of the agreed-upon procedures, the practitioner should attempt to obtain agreement from the specified parties for modification of the agreed-upon procedures. When such agreement cannot be obtained (for example, when the agreed-upon procedures are published by a regulatory agency that will not modify the procedures), the practitioner should describe any restrictions on the performance of procedures in his or her report or withdraw from the engagement.

Adding Specified Parties (Nonparticipant Parties)

.36 Subsequent to the completion of the agreed-upon procedures engagement, a practitioner may be requested to consider the addition of another party as a specified party (*a nonparticipant party*). The practitioner may agree to add a nonparticipant party as a specified party, based on consideration of such factors as the identity of the nonparticipant party and the intended use of the report.[16] If the practitioner does agree to add the nonparticipant party, he or she should obtain affirmative acknowledgment, normally in writing, from the nonparticipant party agreeing to the procedures performed and of its taking responsibility for the sufficiency of the procedures. If the nonparticipant party is added after the practitioner has issued his or her report, the report may be reissued or the practitioner may provide other written acknowledgment that the nonparticipant party has been added as a specified party. If the report is reissued, the report date should not be changed. If the practitioner provides written acknowledgment that the nonparticipant party has been added as a specified party, such written acknowledgment ordinarily should state that no procedures have been performed subsequent to the date of the report.

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[16] When considering whether to add a nonparticipant party, the guidance in paragraphs .A27–.A28 of AU-C section 560, *Subsequent Events and Subsequently Discovered Facts*, may be helpful. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Written Representations

.37 A practitioner may find a representation letter to be a useful and practical means of obtaining representations from the responsible party. The need for such a letter may depend on the nature of the engagement and the specified parties. For example, paragraph .68 of section 601 requires a practitioner to obtain written representations from the responsible party in an agreed-upon procedures engagement related to compliance with specified requirements.

.38 Examples of matters that might appear in a representation letter from the responsible party include the following:

a. A statement acknowledging responsibility for the subject matter and, when applicable, the assertion

b. A statement acknowledging responsibility for selecting the criteria and for determining that such criteria are appropriate for their purposes

c. The assertion about the subject matter based on the criteria selected

d. A statement that all known matters contradicting the subject matter or the assertion and any communication from regulatory agencies affecting the subject matter or the assertion has been disclosed to the practitioner

e. Availability of all records relevant to the subject matter and the agreed-upon procedures

f. Other matters as the practitioner deems appropriate

.39 The responsible party's refusal to furnish written representations determined by the practitioner to be appropriate for the engagement constitutes a limitation on the performance of the engagement. In such circumstances, the practitioner should do one of the following.

a. Disclose in his or her report the inability to obtain representations from the responsible party.

b. Withdraw from the engagement.[17]

c. Change the engagement to another form of engagement.

Knowledge of Matters Outside Agreed-Upon Procedures

.40 The practitioner need not perform procedures beyond the agreed-upon procedures. However, in connection with the application of agreed-upon procedures, if matters come to the practitioner's attention by other means that significantly contradict the subject matter (or written assertion related thereto) referred to in the practitioner's report, the practitioner should include this matter in his or her report.[18] For example, if, during the course of applying

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[17] For an agreed-upon procedures engagement performed pursuant to section 601, management's refusal to furnish all required representations also constitutes a limitation on the scope of the engagement that requires the practitioner to withdraw from the engagement.

[18] If the practitioner has performed (or has been engaged to perform) an audit of the entity's financial statements to which an element, account, or item of a financial statement relates and the auditor's report on such financial statements includes a departure from a standard report (see AU-C section 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*), he or she should consider including a reference to the auditor's report and the departure from the standard report in his or her agreed-upon procedures report. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

agreed-upon procedures regarding an entity's internal control, the practitioner becomes aware of a material weakness by means other than performance of the agreed-upon procedure, the practitioner should include this matter in his or her report.

Change to an Agreed-Upon Procedures Engagement From Another Form of Engagement

.41 A practitioner who has been engaged to perform another form of attest engagement or a nonattest service engagement may, before the engagement's completion, be requested to change the engagement to an agreed-upon procedures engagement under this section. A request to change the engagement may result from a change in circumstances affecting the client's requirements, a misunderstanding about the nature of the original services or the alternative services originally available, or a restriction on the performance of the original engagement, whether imposed by the client or caused by circumstances.

.42 Before a practitioner who was engaged to perform another form of engagement agrees to change the engagement to an agreed-upon procedures engagement, he or she should consider the following:

a. The possibility that certain procedures performed as part of another type of engagement are not appropriate for inclusion in an agreed-upon procedures engagement

b. The reason given for the request, particularly the implications of a restriction on the scope of the original engagement or the matters to be reported

c. The additional effort required to complete the original engagement

d. If applicable, the reasons for changing from a general-use report to a restricted-use report

.43 If the specified parties acknowledge agreement to the procedures performed or to be performed and assume responsibility for the sufficiency of the procedures to be included in the agreed-upon procedures engagement, either of the following would be considered a reasonable basis for requesting a change in the engagement—

a. A change in circumstances that requires another form of engagement

b. A misunderstanding concerning the nature of the original engagement or the available alternatives

.44 In all circumstances, if the original engagement procedures are substantially complete or the effort to complete such procedures is relatively insignificant, the practitioner should consider the propriety of accepting a change in the engagement.

.45 If the practitioner concludes, based on his or her professional judgment, that there is reasonable justification to change the engagement, and provided he or she complies with the standards applicable to agreed-upon procedures engagements, the practitioner should issue an appropriate agreed-upon procedures report. The report should not include reference to either the original engagement or performance limitations that resulted in the changed engagement. (See paragraph .40.)

Combined Reports Covering Both Restricted-Use and General-Use Subject Matter or Presentations

.46 When a practitioner performs services pursuant to an engagement to apply agreed-upon procedures to specific subject matter as part of or in addition to another form of service, this section applies only to those services described herein; other Standards would apply to the other services. Other services may include an audit, review, or compilation of a financial statement, another attest service performed pursuant to the SSAEs, or a nonattest service.[19] Reports on applying agreed-upon procedures to specific subject matter may be combined with reports on such other services, provided the types of services can be clearly distinguished and the applicable Standards for each service are followed. See paragraphs .82–.83 of section 101 regarding restricting the use of the combined report.

Effective Date

.47 This section is effective when the subject matter or assertion is as of or for a period ending on or after June 1, 2001. Early application is permitted.

[19] See paragraphs .105–.107 of section 101 for requirements relating to attest services provided as part of a consulting service engagement.

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Appendix

Additional Illustrative Reports

The following are additional illustrations of reporting on applying agreed-upon procedures to elements, accounts, or items of a financial statement.

1. Report in Connection With a Proposed Acquisition

Independent Accountant's Report
on Applying Agreed-Upon Procedures

To the Board of Directors and Management of X Company:

We have performed the procedures enumerated below, which were agreed to by the Board of Directors and Management of X Company, solely to assist you in connection with the proposed acquisition of Y Company as of December 31, 20XX. Y Company is responsible for its cash and accounts receivable records. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of the parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

The procedures and the associated findings are as follows:

Cash

1. We obtained confirmation of the cash on deposit from the following banks, and we agreed the confirmed balance to the amount shown on the bank reconciliations maintained by Y Company. We mathematically checked the bank reconciliations and compared the resultant cash balances per book to the respective general ledger account balances.

Bank	*General Ledger Account Balances as of December 31, 20XX*
ABC National Bank	$ 5,000
DEF State Bank	3,776
XYZ Trust Company regular account	86,912
XYZ Trust Company payroll account	5,000
	$110,688

We found no exceptions as a result of the procedures.

Accounts Receivable

2. We added the individual customer account balances shown in an aged trial balance of accounts receivable (identified as Exhibit A) and compared the resultant total with the balance in the general ledger account.

   We found no difference.

3. We compared the individual customer account balances shown in the aged trial balance of accounts receivable (Exhibit A) as of December 31, 19XX, to the balances shown in the accounts receivable subsidiary ledger.

   We found no exceptions as a result of the comparisons.

4. We traced the aging (according to invoice dates) for 50 customer account balances shown in Exhibit A to the details of outstanding invoices in the accounts receivable subsidiary ledger. The balances selected for tracing were determined by starting at the eighth item and selecting every fifteenth item thereafter.

   We found no exceptions in the aging of the amounts of the 50 customer account balances selected. The sample size traced was 9.8 percent of the aggregate amount of the customer account balances.

5. We mailed confirmations directly to the customers representing the 150 largest customer account balances selected from the accounts receivable trial balance, and we received responses as indicated below. We also traced the items constituting the outstanding customer account balance to invoices and supporting shipping documents for customers from which there was no reply. As agreed, any individual differences in a customer account balance of less than $300 were to be considered minor, and no further procedures were performed.

   Of the 150 customer balances confirmed, we received responses from 140 customers; 10 customers did not reply. No exceptions were identified in 120 of the confirmations received. The differences disclosed in the remaining 20 confirmation replies were either minor in amount (as defined above) or were reconciled to the customer account balance without proposed adjustment thereto. A summary of the confirmation results according to the respective aging categories is as follows.

	Accounts Receivable December 31, 20XX		
Aging Categories	*Customer Account Balances*	*Confirmations Requested*	*Confirmations Received*
Current	$156,000	$ 76,000	$ 65,000
Past due:			
Less than one month:	60,000	30,000	19,000
One to three months	36,000	18,000	10,000
Over three months	48,000	48,000	8,000
	$300,000	$172,000	$102,000

We were not engaged to and did not conduct an audit, the objective of which would be the expression of an opinion on cash and accounts receivable. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the board of directors and management of X Company and is not intended to be and should not be used by anyone other than these specified parties.

[*Signature*]

[*Date*]

2. Report in Connection With Claims of Creditors

Independent Accountant's Report
on Applying Agreed-Upon Procedures

To the Trustee of XYZ Company:

We have performed the procedures described below, which were agreed to by the Trustee of XYZ Company, with respect to the claims of creditors solely to assist you in determining the validity of claims of XYZ Company as of May 31, 20XX, as set forth in the accompanying Schedule A. XYZ Company is responsible for maintaining records of claims submitted by creditors of XYZ Company. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of the party specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

The procedures and associated findings are as follows:

1. Compare the total of the trial balance of accounts payable at May 31, 20XX, prepared by XYZ Company, to the balance in the related general ledger account.

   The total of the accounts payable trial balance agreed with the balance in the related general ledger account.

2. Compare the amounts for claims received from creditors (as shown in claim documents provided by XYZ Company) to the respective amounts shown in the trial balance of accounts payable. Using the data included in the claims documents and in XYZ Company's accounts payable detail records, reconcile any differences found to the accounts payable trial balance.

   All differences noted are presented in column 3 of Schedule A. Except for those amounts shown in column 4 of Schedule A, all such differences were reconciled.

3. Obtain the documentation submitted by creditors in support of the amounts claimed and compare it to the following documentation in XYZ Company's files: invoices, receiving reports, and other evidence of receipt of goods or services.

   No exceptions were found as a result of these comparisons.

We were not engaged to and did not conduct an audit, the objective of which would be the expression of an opinion on the claims of creditors set forth in the accompanying Schedule A. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the Trustee of XYZ Company and is not intended to be and should not be used by anyone other than this specified party.

[*Signature*]

[*Date*]

AT Section 301

Financial Forecasts and Projections

Source: SSAE No. 10; SSAE No. 11; SSAE No. 17.

Effective when the date of the practitioner's report is on or after June 1, 2001, unless otherwise indicated.

Introduction

.01 This section sets forth standards and provides guidance to practitioners who are engaged to issue or do issue examination (paragraphs .29–.50), compilation (paragraphs .12–.28), or agreed-upon procedures reports (paragraphs .51–.56) on prospective financial statements.

.02 Whenever a practitioner (*a*) submits, to his or her client or others, prospective financial statements that he or she has assembled, or assisted in assembling, that are or reasonably might be expected to be used by another (third) party[1] or (*b*) reports on prospective financial statements that are, or reasonably might be expected to be used by another (third) party, the practitioner should perform one of the engagements described in the preceding paragraph. In deciding whether the prospective financial statements are or reasonably might be expected to be used by a third party, the practitioner may rely on either the written or oral representation of the responsible party, unless information comes to his or her attention that contradicts the responsible party's representation. If such third-party use of the prospective financial statements is not reasonably expected, the provisions of this section are not applicable unless the practitioner has been engaged to examine, compile, or apply agreed-upon procedures to the prospective financial statements.

.03 This section also provides standards for a practitioner who is engaged to examine, compile, or apply agreed-upon procedures to partial presentations. A partial presentation is a presentation of prospective financial information that excludes one or more of the items required for prospective financial statements as described in appendix A [paragraph .68], "Minimum Presentation Guidelines."

.04 The practitioner who has been engaged to or does compile, examine, or apply agreed-upon procedures to a partial presentation should perform the engagement in accordance with the guidance in paragraphs .12–.28 for compilations, .29–.50 for examinations, and .51–.56 for agreed-upon procedures, respectively, modified to reflect the nature of the presentation as discussed in paragraphs .03 and .57–.58.

.05 This section does not provide standards or procedures for engagements involving prospective financial statements used solely in connection with litigation support services. A practitioner may, however, look to these standards because they provide helpful guidance for many aspects of such engagements and may be referred to as useful guidance in such engagements. Litigation support services are engagements involving pending or potential formal legal proceedings before a trier of fact in connection with the resolution

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[1] However, paragraph .59 permits an exception to this for certain types of budgets.

of a dispute between two or more parties, for example, when a practitioner acts as an expert witness. This exception is provided because, among other things, the practitioner's work in such proceedings is ordinarily subject to detailed analysis and challenge by each party to the dispute. This exception does not apply, however, if either of the following occur.

a. The practitioner is specifically engaged to issue or does issue an examination, a compilation, or an agreed-upon procedures report on prospective financial statements.

b. The prospective financial statements are for use by third parties who, under the rules of the proceedings, do not have the opportunity for analysis and challenge by each party to a dispute in a legal proceeding.

For example, creditors may not have such opportunities when prospective financial statements are submitted to them to secure their agreement to a plan of reorganization.

.06 In reporting on prospective financial statements, the practitioner may be called on to assist the responsible party in identifying assumptions, gathering information, or assembling the statements.[2] The responsible party is nonetheless responsible for the preparation and presentation of the prospective financial statements because the prospective financial statements are dependent on the actions, plans, and assumptions of the responsible party, and only it can take responsibility for the assumptions. Accordingly, the practitioner's engagement should not be characterized in his or her report or in the document containing his or her report as including "preparation" of the prospective financial statements. A practitioner may be engaged to prepare a financial analysis of a potential project where the engagement includes obtaining the information, making appropriate assumptions, and assembling the presentation. Such an analysis is not and should not be characterized as a forecast or projection and would not be appropriate for general use. However, if the responsible party reviewed and adopted the assumptions and presentation, or based its assumptions and presentation on the analysis, the practitioner could perform one of the engagements described in this section and issue a report appropriate for general use.

.07 The concept of materiality affects the application of this section to prospective financial statements as materiality affects the application of generally accepted auditing standards (GAAS) to historical financial statements. Materiality is a concept that is judged in light of the expected range of reasonableness of the information; therefore, users should not expect prospective information (information about events that have not yet occurred) to be as precise as historical information.

Definitions

.08 For the purposes of this section the following definitions apply.

a. *Prospective financial statements*—Either financial forecasts or financial projections including the summaries of significant assumptions and accounting policies. Although prospective financial statements may cover a period that has partially expired, statements for periods that have completely expired are not considered to be prospective

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[2] Some of these services may not be appropriate if the practitioner is to be named as the person reporting on an examination in a filing with the Securities and Exchange Commission (SEC). SEC Release Nos. 33-5992 and 34-15305, "Disclosure of Projections of Future Economic Performance," state that for prospective financial statements filed with the commission, "a person should not be named as an outside reviewer if he actively assisted in the preparation of the projection."

financial statements. Pro forma financial statements and partial presentations are not considered to be prospective financial statements.[3]

b. *Partial presentation*—A presentation of prospective financial information that excludes one or more of the items required for prospective financial statements as described in appendix A (paragraph .68), "Minimum Presentation Guidelines." Partial presentations are not ordinarily appropriate for general use; accordingly, partial presentations should be restricted for use by specified parties who will be negotiating directly with the responsible party.

c. *Financial forecast*—Prospective financial statements that present, to the best of the responsible party's knowledge and belief, an entity's expected financial position, results of operations, and cash flows. A financial forecast is based on the responsible party's assumptions reflecting the conditions it expects to exist and the course of action it expects to take. A financial forecast may be expressed in specific monetary amounts as a single point estimate of forecasted results or as a range, where the responsible party selects key assumptions to form a range within which it reasonably expects, to the best of its knowledge and belief, the item or items subject to the assumptions to actually fall. When a forecast contains a range, the range is not selected in a biased or misleading manner, for example, a range in which one end is significantly less expected than the other. Minimum presentation guidelines for prospective financial statements are set forth in appendix A (paragraph .68).

d. *Financial projection*—Prospective financial statements that present, to the best of the responsible party's knowledge and belief, given one or more hypothetical assumptions, an entity's expected financial position, results of operations, and cash flows. A financial projection is sometimes prepared to present one or more hypothetical courses of action for evaluation, as in response to a question such as, "What would happen if . . . ?" A financial projection is based on the responsible party's assumptions reflecting conditions it expects would exist and the course of action it expects would be taken, given one or more hypothetical assumptions. A projection, like a forecast, may contain a range. Minimum presentation guidelines for prospective financial statements are set forth in appendix A (paragraph .68).

e. *Entity*—Any unit, existing or to be formed, for which financial statements could be prepared in accordance with generally accepted accounting principles (GAAP) or a special purpose framework.[4] For example, an entity can be an individual, partnership, corporation, trust, estate, association, or governmental unit.

f. *Hypothetical assumption*—An assumption used in a financial projection to present a condition or course of action that is not necessarily expected to occur, but is consistent with the purpose of the projection.

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[3] The objective of pro forma financial information is to show what the significant effects on the historical financial information might have been had a consummated or proposed transaction (or event) occurred at an earlier date. Although the transaction in question may be prospective, this section does not apply to such presentations because they are essentially historical financial statements and do not purport to be prospective financial statements. See section 401, *Reporting on Pro Forma Financial Information*.

[4] AU-C section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, defines a *special purpose framework* as a cash, tax, regulatory, or contractual basis of accounting (commonly referred to as *comprehensive bases of accounting other than GAAP*). [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

g. *Responsible party*—The person or persons who are responsible for the assumptions underlying the prospective financial statements. The responsible party usually is management, but it can be persons outside of the entity who do not currently have the authority to direct operations (for example, a party considering acquiring the entity).

h. *Assembly*—The manual or computer processing of mathematical or other clerical functions related to the presentation of the prospective financial statements. Assembly does not refer to the mere reproduction and collation of such statements or to the responsible party's use of the practitioner's computer processing hardware or software.

i. *Key factors*—The significant matters on which an entity's future results are expected to depend. Such factors are basic to the entity's operations and thus encompass matters that affect, among other things, the entity's sales, production, service, and financing activities. Key factors serve as a foundation for prospective financial statements and are the bases for the assumptions.

[Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Uses of Prospective Financial Statements

.09 Prospective financial statements are for either *general use* or *limited use*. *General use* of prospective financial statements refers to the use of the statements by persons with whom the responsible party is not negotiating directly, for example, in an offering statement of an entity's debt or equity interests. Because recipients of prospective financial statements distributed for general use are unable to ask the responsible party directly about the presentation, the presentation most useful to them is one that portrays, to the best of the responsible party's knowledge and belief, the expected results. Thus, only a financial forecast is appropriate for general use.

.10 *Limited use* of prospective financial statements refers to the use of prospective financial statements by the responsible party alone or by the responsible party and third parties with whom the responsible party is negotiating directly. Examples include use in negotiations for a bank loan, submission to a regulatory agency, and use solely within the entity. Third-party recipients of prospective financial statements intended for limited use can ask questions of the responsible party and negotiate terms directly with it. Any type of prospective financial statements that would be useful in the circumstances would normally be appropriate for limited use. Thus, the presentation may be a financial forecast or a financial projection.

.11 Because a financial projection is not appropriate for general use, a practitioner should not consent to the use of his or her name in conjunction with a financial projection that he or she believes will be distributed to those who will not be negotiating directly with the responsible party, for example, in an offering statement of an entity's debt or equity interests, unless the projection is used to supplement a financial forecast.

Compilation of Prospective Financial Statements

.12 A compilation of prospective financial statements is a professional service that involves the following:

a. Assembling, to the extent necessary, the prospective financial statements based on the responsible party's assumptions *b.* Performing the required compilation procedures,[5] including reading the prospective financial statements with their summaries of significant assumptions and accounting policies, and considering whether they appear to be presented in conformity with AICPA presentation guidelines[6] and not obviously inappropriate

c. Issuing a compilation report

.13 A compilation is not intended to provide assurance on the prospective financial statements or the assumptions underlying such statements. Because of the limited nature of the practitioner's procedures, a compilation does not provide assurance that the practitioner will become aware of significant matters that might be disclosed by more extensive procedures, for example, those performed in an examination of prospective financial statements.

.14 The summary of significant assumptions is essential to the reader's understanding of prospective financial statements. Accordingly, the practitioner should not compile prospective financial statements that exclude disclosure of the summary of significant assumptions. Also, the practitioner should not compile a financial projection that excludes either (*a*) an identification of the hypothetical assumptions or (*b*) a description of the limitations on the usefulness of the presentation.

.15 The following standards apply to a compilation of prospective financial statements and to the resulting report.

a. The compilation should be performed by a person or persons having adequate technical training and proficiency to compile prospective financial statements.

b. Due professional care should be exercised in the performance of the compilation and the preparation of the report.

c. The work should be adequately planned, and assistants, if any, should be properly supervised.

d. Applicable compilation procedures should be performed as a basis for reporting on the compiled prospective financial statements. (See appendix B [paragraph .69], "Training and Proficiency, Planning and Procedures Applicable to Compilations," for the procedures to be performed.)

e. The report based on the practitioner's compilation of prospective financial statements should conform to the applicable guidance in paragraphs .18–.28.

.16 The practitioner should consider, after applying the procedures specified in paragraph .69, whether representations or other information he or she has received appear to be obviously inappropriate, incomplete, or otherwise misleading, and if so, the practitioner should attempt to obtain additional or revised information. If he or she does not receive such information, the practitioner should ordinarily withdraw from the compilation engagement.[7] (Note that the

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[5] See appendix B (paragraph .69), subparagraph 5, for the required procedures.

[6] AICPA presentation guidelines are detailed in AICPA Guide *Prospective Financial Information*.

[7] The practitioner need not withdraw from the engagement if the effect of such information on the prospective financial statement does not appear to be material.

omission of disclosures, other than those relating to significant assumptions, would not require the practitioner to withdraw. See paragraph .26.)

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[.17] [Paragraph deleted by the issuance of SSAE No. 11, January 2002.]

Reports on Compiled Prospective Financial Statements

.18 The practitioner's standard report on a compilation of prospective financial statements should include the following:

a. An identification of the prospective financial statements presented by the responsible party

b. A statement that the practitioner has compiled the prospective financial statements in accordance with attestation standards established by the American Institute of Certified Public Accountants

c. A statement that a compilation is limited in scope and does not enable the practitioner to express an opinion or any other form of assurance on the prospective financial statements or the assumptions

d. A caveat that the prospective results may not be achieved

e. A statement that the practitioner assumes no responsibility to update the report for events and circumstances occurring after the date of the report

f. The manual or printed signature of the practitioner's firm

g. The date of the compilation report

.19 The following is the form of the practitioner's standard report on the compilation of a forecast that does not contain a range.[8]

> We have compiled the accompanying forecasted balance sheet, statements of income, retained earnings, and cash flows of XYZ Company as of December 31, 20XX, and for the year then ending, in accordance with attestation standards established by the American Institute of Certified Public Accountants.[9]
>
> A compilation is limited to presenting in the form of a forecast information that is the representation of management[10] and does not include evaluation of the support for the assumptions underlying the forecast. We have not examined the forecast and, accordingly, do not express an opinion or any other form of

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[8] The forms of reports provided in this section are appropriate whether the presentation is based on GAAP or on a special purpose framework. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

[9] When the presentation is summarized as discussed in appendix A (paragraph .68), this sentence might read, "We have compiled the accompanying summarized forecast of XYZ Company as of December 31, 20XX, and for the year then ending in accordance with attestation standards established by the American Institute of Certified Public Accountants."

[10] If the responsible party is other than management, the references to management in the standard reports provided in this section should be changed to refer to the party who assumes responsibility for the assumptions.

assurance on the accompanying statements or assumptions. Furthermore, there will usually be differences between the forecasted and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

[*Signature*]

[*Date*]

.20 When the presentation is a projection, the practitioner's compilation report should include the report elements set forth in paragraph .18. Additionally, the report should include a statement describing the special purpose for which the projection was prepared as well as a separate paragraph that restricts the use of the report because it is intended to be used solely by the specified parties. The following is the form of the practitioner's standard report on a compilation of a projection that does not contain a range.

We have compiled the accompanying projected balance sheet, statements of income, retained earnings, and cash flows of XYZ Company as of December 31, 20XX, and for the year then ending, in accordance with attestation standards established by the American Institute of Certified Public Accountants.[11] The accompanying projection was prepared for [*state special purpose, for example, "the purpose of negotiating a loan to expand XYZ Company's plant"*].

A compilation is limited to presenting in the form of a projection information that is the representation of management and does not include evaluation of the support for the assumptions underlying the projection. We have not examined the projection and, accordingly, do not express an opinion or any other form of assurance on the accompanying statements or assumptions. Furthermore, even if [*describe hypothetical assumption, for example, "the loan is granted and the plant is expanded,"*] there will usually be differences between the projected and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

The accompanying projection and this report are intended solely for the information and use of [*identify specified parties, for example, "XYZ Company and DEF Bank"*] and is not intended to be and should not be used by anyone other than these specified parties.

[*Signature*]

[*Date*]

.21 When the prospective financial statements contain a range, the practitioner's standard report should also include a separate paragraph that states that the responsible party has elected to portray the expected results of one or more assumptions as a range. The following is an example of the separate paragraph to be added to the practitioner's report when he or she compiles prospective financial statements, in this case a forecast, that contain a range.

As described in the summary of significant assumptions, management of XYZ Company has elected to portray forecasted [*describe financial statement element*

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[11] When the presentation is summarized as discussed in appendix A (paragraph .68), this sentence might read as follows.

We have compiled the accompanying summarized projection of XYZ Company as of December 31, 20XX, and for the year then ending in accordance with attestation standards established by the American Institute of Certified Public Accountants.

or elements for which the expected results of one or more assumptions fall within a range, and identify the assumptions expected to fall within a range, for example, "revenue at the amounts of $X,XXX and $Y,YYY, which is predicated upon occupancy rates of XX percent and YY percent of available apartments,"] rather than as a single point estimate. Accordingly, the accompanying forecast presents forecasted financial position, results of operations, and cash flows [*describe one or more assumptions expected to fall within a range, for example, "at such occupancy rates."*] However, there is no assurance that the actual results will fall within the range of [*describe one or more assumptions expected to fall within a range, for example, "occupancy rates"*] presented.

.22 The date of completion of the practitioner's compilation procedures should be used as the date of the report.

.23 A practitioner may compile prospective financial statements for an entity with respect to which he or she is not independent.[12] In such circumstances, the practitioner's report should be modified to indicate his or her lack of independence in a separate paragraph of the practitioner's report. An example of such a disclosure would be

We are not independent with respect to XYZ Company.

The practitioner is not precluded from disclosing a description about the reason(s) that his or her independence is impaired. The following are examples of descriptions the practitioner may use:

a. We are not independent with respect to XYZ Company as of and for the year ended [*or ending, as applicable*] December 31, 20XX, because a member of the engagement team had a direct financial interest in XYZ Company.

b. We are not independent with respect to XYZ Company as of and for the year ended [*or ending, as applicable*] December 31, 20XX, because an immediate family member of one of the members of the engagement team was employed by XYZ Company.

c. We are not independent with respect to XYZ Company as of and for the year ended [*or ending, as applicable*] December 31, 20XX, because we performed certain accounting services (the practitioner may include a specific description of those services) that impaired our independence.

If the accountant elects to disclose a description about the reasons his or her independence is impaired, the accountant should ensure that all reasons are included in the description.

[As amended, effective for compilations of prospective financial statements for periods ending on or after December 15, 2010, by SSAE No. 17.]

.24 Prospective financial statements may be included in a document that also contains historical financial statements and the practitioner's report thereon.[13] In addition, the historical financial statements that appear in the document may be summarized and presented with the prospective financial statements for comparative purposes.[14] An example of the reference to the

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[12] In making a judgment about whether he or she is independent, the practitioner should be guided by the AICPA Code of Professional Conduct. [Footnote amended, effective for compilations of prospective financial statements for periods ending on or after December 15, 2010, by SSAE No. 17.]

[13] Footnote revised, November 2002, to reflect conforming changes necessary due to the issuance of SSARS No. 9. Footnote deleted, December 2012, to reflect conforming changes necessary due to the issuance of SSARS No. 19 and SAS Nos. 122–126.]

[14] AU-C section 810, *Engagements to Report on Summary Financial Statements*, addresses the auditor's responsibilities relating to an engagement to report separately on summary financial

practitioner's report on the historical financial statements when he or she audited, reviewed, or compiled those statements is presented below.

[*Concluding sentence of last paragraph*]

> The historical financial statements for the year ended December 31, 20XX, [*from which the historical data are derived*] and our report thereon are set forth on pages XX-XX of this document.

.25 In some circumstances, a practitioner may wish to expand his or her report to emphasize a matter regarding the prospective financial statements. Such information may be presented in a separate paragraph of the practitioner's report. However, the practitioner should exercise care that emphasizing such a matter does not give the impression that he or she is expressing assurance or expanding the degree of responsibility he or she is taking with respect to such information.[15] For example, the practitioner should not include statements in his or her compilation report about the mathematical accuracy of the statements or their conformity with presentation guidelines.

Modifications of the Standard Compilation Report

.26 An entity may request a practitioner to compile prospective financial statements that contain presentation deficiencies or omit disclosures other than those relating to significant assumptions. The practitioner may compile such prospective financial statements provided the deficiency or omission is clearly indicated in his or her report and is not, to his or her knowledge, undertaken with the intention of misleading those who might reasonably be expected to use such statements.

.27 Notwithstanding the preceding, if the compiled prospective financial statements are prepared in accordance with a special purpose financial reporting framework and do not include disclosure of the framework used, the framework should be disclosed in the practitioner's report. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.28 The following is an example of a paragraph that should be added to a report on compiled prospective financial statements, in this case a financial forecast, in which the summary of significant accounting policies has been omitted.

> Management has elected to omit the summary of significant accounting policies required by the guidelines for presentation of a forecast established by the American Institute of Certified Public Accountants. If the omitted disclosures were included in the forecast, they might influence the user's conclusions about the Company's financial position, results of operations, and cash flows for the forecast period. Accordingly, this forecast is not designed for those who are not informed about such matters.

Examination of Prospective Financial Statements

.29 An examination of prospective financial statements is a professional service that involves—

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statements derived from financial statements audited in accordance with generally accepted auditing standards by the same auditor. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

[15] However, the practitioner may provide assurance on tax matters in order to comply with the requirements of regulations governing practice before the Internal Revenue Service (IRS) contained in 31 CFR pt. 10 (Treasury Department Circular No. 230).

a. Evaluating the preparation of the prospective financial statements.

b. Evaluating the support underlying the assumptions.

c. Evaluating the presentation of the prospective financial statements for conformity with AICPA presentation guidelines.[16]

d. Issuing an examination report.

.30 As a result of his or her examination, the practitioner has a basis for reporting on whether, in his or her opinion—

a. The prospective financial statements are presented in conformity with AICPA guidelines.

b. The assumptions provide a reasonable basis for the responsible party's forecast, or whether the assumptions provide a reasonable basis for the responsible party's projection given the hypothetical assumptions.

.31 The practitioner should follow the general, fieldwork, and reporting standards for attestation engagements established in section 50, *SSAE Hierarchy*, and further explained in section 101, *Attest Engagements*, in performing an examination of prospective financial statements and reporting thereon. (See paragraph .70 for standards concerning such technical training and proficiency, planning the examination engagement, and the types of procedures a practitioner should perform to obtain sufficient evidence for his or her examination report.) [Revised, November 2006, to reflect conforming changes necessary due to the issuance of SSAE No. 14.]

Working Papers

[.32] [Paragraph deleted by the issuance of SSAE No. 11, January 2002.]

Reports on Examined Prospective Financial Statements

.33 The practitioner's standard report on an examination of prospective financial statements should include the following:

a. A title that includes the word *independent*

b. An identification of the prospective financial statements presented

c. An identification of the responsible party and a statement that the prospective financial statements are the responsibility of the responsible party

d. A statement that the practitioner's responsibility is to express an opinion on the prospective financial statements based on his or her examination

e. A statement that the examination of the prospective financial statements was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included such procedures as the practitioner considered necessary in the circumstances

f. A statement that the practitioner believes that the examination provides a reasonable basis for his or her opinion

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[16] AICPA presentation guidelines are detailed in AICPA Guide *Prospective Financial Information*.

g. The practitioner's opinion that the prospective financial statements are presented in conformity with AICPA presentation guidelines and that the underlying assumptions provide a reasonable basis for the forecast or a reasonable basis for the projection given the hypothetical assumptions[17]

h. A caveat that the prospective results may not be achieved

i. A statement that the practitioner assumes no responsibility to update the report for events and circumstances occurring after the date of the report

j. The manual or printed signature of the practitioner's firm

k. The date of the examination report

.34 The following is the form of the practitioner's standard report on an examination of a forecast that does not contain a range.

Independent Accountant's Report

We have examined the accompanying forecasted balance sheet, statements of income, retained earnings, and cash flows of XYZ Company as of December 31, 20XX, and for the year then ending.[18] XYZ Company's management is responsible for the forecast. Our responsibility is to express an opinion on the forecast based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included such procedures as we considered necessary to evaluate both the assumptions used by management and the preparation and presentation of the forecast. We believe that our examination provides a reasonable basis for our opinion.

In our opinion, the accompanying forecast is presented in conformity with guidelines for presentation of a forecast established by the American Institute of Certified Public Accountants, and the underlying assumptions provide a reasonable basis for management's forecast. However, there will usually be differences between the forecasted and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

[*Signature*]

[*Date*]

.35 When a practitioner examines a projection, his or her opinion regarding the assumptions should be conditioned on the hypothetical assumptions; that is, he or she should express an opinion on whether the assumptions provide a reasonable basis for the projection given the hypothetical assumptions. The practitioner's examination report on a projection should include the report elements set forth in paragraph .33. Additionally, the report should include a statement describing the special purpose for which the projection was prepared as well a separate paragraph that restricts the use of the report because it is

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[17] The practitioner's report need not comment on the consistency of the application of accounting principles as long as the presentation of any change in accounting principles is in conformity with AICPA presentation guidelines as detailed in AICPA Guide *Prospective Financial Information*.

[18] When the presentation is summarized as discussed in appendix A (paragraph .68), this sentence might read, "We have examined the accompanying summarized forecast of XYZ Company as of December 31, 20XX, and for the year then ending."

intended to be used solely by specified parties. The following is the form of the practitioner's standard report on an examination of a projection that does not contain a range.

Independent Accountant's Report

We have examined the accompanying projected balance sheet, statements of income, retained earnings, and cash flows of XYZ Company as of December 31, 20XX, and for the year then ending.[19] XYZ Company's management is responsible for the projection, which was prepared for [*state special purpose, for example, "the purpose of negotiating a loan to expand XYZ Company's plant"*]. Our responsibility is to express an opinion on the projection based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included such procedures as we considered necessary to evaluate both the assumptions used by management and the preparation and presentation of the projection. We believe that our examination provides a reasonable basis for our opinion.

In our opinion, the accompanying projection is presented in conformity with guidelines for presentation of a projection established by the American Institute of Certified Public Accountants, and the underlying assumptions provide a reasonable basis for management's projection [*describe the hypothetical assumption, for example, "assuming the granting of the requested loan for the purpose of expanding XYZ Company's plant as described in the summary of significant assumptions."*] However, even if [*describe hypothetical assumption, for example, "the loan is granted and the plant is expanded,"*], there will usually be differences between the projected and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

The accompanying projection and this report are intended solely for the information and use of [*identify specified parties, for example, "XYZ Company and DEF National Bank"*] and is not intended to be and should not be used by anyone other than these specified parties.

[*Signature*]

[*Date*]

.36 When the prospective financial statements contain a range, the practitioner's standard report should also include a separate paragraph that states that the responsible party has elected to portray the expected results of one or more assumptions as a range. The following is an example of the separate paragraph to be added to the practitioner's report when he or she examines prospective financial statements, in this case a forecast, that contain a range.

As described in the summary of significant assumptions, management of XYZ Company has elected to portray forecasted [*describe financial statement element or elements for which the expected results of one or more assumptions fall within a range, and identify assumptions expected to fall within a range, for example, "revenue at the amounts of $X,XXX and $Y,YYY, which is predicated upon occupancy rates of XX percent and YY percent of available apartments,"*] rather than as a single point estimate. Accordingly, the accompanying forecast presents forecasted financial position, results of operations, and cash flows [*de-*

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[19] When the presentation is summarized as discussed in appendix A (paragraph .68), this sentence might read, "We have examined the accompanying summarized projection of XYZ Company as of December 31, 20XX, and for the year then ending."

scribe one or more assumptions expected to fall within a range, for example, "*at such occupancy rates.*"] However, there is no assurance that the actual results will fall within the range of [*describe one or more assumptions expected to fall within a range, for example,* "*occupancy rates*"] presented.

.37 The date of completion of the practitioner's examination procedures should be used as the date of the report.

Modifications to the Practitioner's Opinion[20]

.38 The following circumstances result in the following types of modified practitioner's report involving the practitioner's opinion.

a. If, in the practitioner's opinion, the prospective financial statements depart from AICPA presentation guidelines, he or she should express a qualified opinion (see paragraph .39) or an adverse opinion. (See paragraph .41.)[21] However, if the presentation departs from the presentation guidelines because it fails to disclose assumptions that appear to be significant, the practitioner should express an adverse opinion. (See paragraphs .41–.42.)

b. If the practitioner believes that one or more significant assumptions do not provide a reasonable basis for the forecast, or a reasonable basis for the projection given the hypothetical assumptions, he or she should express an adverse opinion. (See paragraph .41.)

c. If the practitioner's examination is affected by conditions that preclude application of one or more procedures he or she considers necessary in the circumstances, he or she should disclaim an opinion and describe the scope limitation in his or her report. (See paragraph .43.)

.39 *Qualified Opinion*. In a qualified opinion, the practitioner should state, in a separate paragraph, all substantive reasons for modifying his or her opinion and describe the departure from AICPA presentation guidelines. His or her opinion should include the words "except" or "exception" as the qualifying language and should refer to the separate explanatory paragraph. The following is an example of an examination report on a forecast that is at variance with AICPA guidelines for presentation of a financial forecast.

Independent Accountant's Report

We have examined the accompanying forecasted balance sheet, statements of income, retained earnings, and cash flows of XYZ Company as of December 31, 20XX, and for the year then ending. XYZ Company's management is responsible for the forecast. Our responsibility is to express an opinion on the forecast based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included such procedures as we considered necessary to evaluate both the assumptions used by management and the preparation and presentation of the forecast. We believe that our examination provides a reasonable basis for our opinion.

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[20] Paragraphs .38–.44 describe circumstances in which the practitioner's standard report on prospective financial statements may require modification. The guidance for modifying the practitioner's standard report is generally applicable to partial presentations. Also, depending on the nature of the presentation, the practitioner may decide to disclose that the partial presentation is not intended to be a presentation of financial position, results of operations, or cash flows. Illustrative reports on partial presentations may be found in AICPA Guide *Prospective Financial Information*.

[21] However, the practitioner may issue the standard examination report on a financial forecast filed with the SEC that meets the presentation requirements of article XI of Regulation S-X.

The forecast does not disclose significant accounting policies. Disclosure of such policies is required by guidelines for presentation of a forecast established by the American Institute of Certified Public Accountants.

In our opinion, except for the omission of the disclosure of the significant accounting policies as discussed in the preceding paragraph, the accompanying forecast is presented in conformity with guidelines for a presentation of a forecast established by the American Institute of Certified Public Accountants and the underlying assumptions provide a reasonable basis for management's forecast. However, there will usually be differences between the forecasted and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

[*Signature*]

[*Date*]

.40 Because of the nature, sensitivity, and interrelationship of prospective information, a reader would find a practitioner's report qualified for a measurement departure,[22] the reasonableness of the underlying assumptions, or a scope limitation difficult to interpret. Accordingly, the practitioner should not express his or her opinion about these items with language such as "except for . . ." or "subject to the effects of. . . ." Rather, when a measurement departure, an unreasonable assumption, or a limitation on the scope of the practitioner's examination has led him or her to conclude that he or she cannot issue an unqualified opinion, he or she should issue the appropriate type of modified opinion described in paragraphs .41–.44.

.41 *Adverse Opinion.* In an adverse opinion the practitioner should state, in a separate paragraph, all of the substantive reasons for his or her adverse opinion. His or her opinion should state that the presentation is not in conformity with presentation guidelines and should refer to the explanatory paragraph. When applicable, his or her opinion paragraph should also state that, in the practitioner's opinion, the assumptions do not provide a reasonable basis for the prospective financial statements. An example of an adverse opinion on an examination of prospective financial statements is set forth below. In this case, a financial forecast was examined and the practitioner's opinion was that a significant assumption was unreasonable. The example should be revised as appropriate for a different type of presentation or if the adverse opinion is issued because the statements do not conform to the presentation guidelines.

Independent Accountant's Report

We have examined the accompanying forecasted balance sheet, statements of income, retained earnings, and cash flows of XYZ Company as of December 31, 20XX, and for the year then ending. XYZ Company's management is responsible for the forecast. Our responsibility is to express an opinion on the forecast based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included such procedures as we considered necessary to evaluate

[22] An example of a measurement departure is the failure to capitalize a capital lease in a forecast where the historical financial statements for the prospective period are expected to be presented in accordance with GAAP.

both the assumptions used by management and the preparation and presentation of the forecast. We believe that our examination provides a reasonable basis for our opinion.

As discussed under the caption "Sales" in the summary of significant forecast assumptions, the forecasted sales include, among other things, revenue from the Company's federal defense contracts continuing at the current level. The Company's present federal defense contracts will expire in March 20XX. No new contracts have been signed and no negotiations are under way for new federal defense contracts. Furthermore, the federal government has entered into contracts with another company to supply the items being manufactured under the Company's present contracts.

In our opinion, the accompanying forecast is not presented in conformity with guidelines for presentation of a financial forecast established by the American Institute of Certified Public Accountants because management's assumptions, as discussed in the preceding paragraph, do not provide a reasonable basis for management's forecast. We have no responsibility to update this report for events or circumstances occurring after the date of this report.

[*Signature*]

[*Date*]

.42 If the presentation, including the summary of significant assumptions, fails to disclose assumptions that, at the time, appear to be significant, the practitioner should describe the assumptions in his or her report and express an adverse opinion. The practitioner should not examine a presentation that omits all disclosures of assumptions. Also, the practitioner should not examine a financial projection that omits (*a*) an identification of the hypothetical assumptions or (*b*) a description of the limitations on the usefulness of the presentation.

.43 *Disclaimer of Opinion.* In a disclaimer of opinion, the practitioner's report should indicate, in a separate paragraph, the respects in which the examination did not comply with standards for an examination. The practitioner should state that the scope of the examination was not sufficient to enable him or her to express an opinion with respect to the presentation or the underlying assumptions, and his or her disclaimer of opinion should include a direct reference to the explanatory paragraph. The following is an example of a report on an examination of prospective financial statements, in this case a financial forecast, for which a significant assumption could not be evaluated.

Independent Accountant's Report

We were engaged to examine the accompanying forecasted balance sheet, statements of income, retained earnings, and cash flows of XYZ Company as of December 31, 20XX, and for the year then ending. XYZ Company's management is responsible for the forecast.

As discussed under the caption "Income From Investee" in the summary of significant forecast assumptions, the forecast includes income from an equity investee constituting 23 percent of forecasted net income, which is management's estimate of the Company's share of the investee's income to be accrued for 20XX. The investee has not prepared a forecast for the year ending December 31, 20XX, and we were therefore unable to obtain suitable support for this assumption.

Because, as described in the preceding paragraph, we are unable to evaluate management's assumption regarding income from an equity investee and other assumptions that depend thereon, the scope of our work was not sufficient to express, and we do not express, an opinion with respect to the presentation of or the assumptions underlying the accompanying forecast. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

[*Signature*]

[*Date*]

.44 When there is a scope limitation and the practitioner also believes there are material departures from the presentation guidelines, those departures should be described in the practitioner's report.

Other Modifications to the Standard Examination Report

.45 The circumstances described below, although not necessarily resulting in modifications to the practitioner's opinion, would result in the following types of modifications to the standard examination report.

.46 *Emphasis of a Matter.* In some circumstances, the practitioner may wish to emphasize a matter regarding the prospective financial statements but nevertheless intends to express an unqualified opinion. The practitioner may present other information and comments he or she wishes to include, such as explanatory comments or other informative material, in a separate paragraph of his or her report.

.47 *Evaluation Based in Part on a Report of Another Practitioner.* When more than one practitioner is involved in the examination, the guidance provided for that situation in connection with examinations of historical financial statements is generally applicable. When the principal practitioner decides to refer to the report of another practitioner as a basis, in part, for his or her own opinion, he or she should disclose that fact in stating the scope of the examination and should refer to the report of the other practitioner in expressing his or her opinion. Such a reference indicates the division of responsibility for the performance of the examination.

.48 *Comparative Historical Financial Information.* Prospective financial statements may be included in a document that also contains historical financial statements and a practitioner's report thereon.[23] In addition, the historical financial statements that appear in the document may be summarized and presented with the prospective financial statements for comparative purposes.[24] An example of the reference to the practitioner's report on the historical financial statements when he or she audited, reviewed, or compiled those statements is presented in paragraph .24.

.49 *Reporting When the Examination Is Part of a Larger Engagement.* When the practitioner's examination of prospective financial statements is part of a larger engagement, for example, a financial feasibility study or business acquisition study, it is appropriate to expand the report on the examination of the prospective financial statements to describe the entire engagement.

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[23] [Footnote revised, November 2002, to reflect conforming changes necessary due to the issuance of SSARS No. 9. Footnote deleted, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

[24] AU-C section 810, *Engagements to Report on Summary Financial Statements*, addresses the auditor's responsibilities relating to an engagement to report separately on summary financial statements derived from financial statements audited in accordance with GAAS by the same auditor. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.50 The following is a report that might be issued when a practitioner chooses to expand his or her report on a financial feasibility study.[25]

Independent Accountant's Report

a. The Board of Directors
Example Hospital
Example, Texas

b. We have prepared a financial feasibility study of Example Hospital's (the Hospital's) plans to expand and renovate its facilities. The study was undertaken to evaluate the ability of the Hospital to meet its operating expenses, working capital needs, and other financial requirements, including the debt service requirements associated with the proposed $25,000,000 [*legal title of bonds*] issue, at an assumed average annual interest rate of 10.0 percent during the five years ending December 31, 20X6.

c. The proposed capital improvements program (the Program) consists of a new two-level addition, which is to provide fifty additional medical-surgical beds, increasing the complement to 275 beds. In addition, various administrative and support service areas in the present facilities are to be remodeled. The Hospital administration anticipates that construction is to begin June 30, 20X2, and to be completed by December 31, 20X3.

d. The estimated total cost of the Program is approximately $30,000,000. It is assumed that the $25,000,000 of revenue bonds that the Example Hospital Finance Authority proposes to issue would be the primary source of funds for the Program. The responsibility for payment of debt service on the bonds is solely that of the Hospital. Other necessary funds to finance the Program are assumed to be provided from the Hospital's funds, from a local fund drive, and from interest earned on funds held by the bond trustee during the construction period.

e. Our procedures included analysis of the following:

- Program history, objectives, timing, and financing
- The future demand for the Hospital's services, including consideration of the following:
  - — Economic and demographic characteristics of the Hospital's defined service area
  - — Locations, capacities, and competitive information pertaining to other existing and planned area hospitals
  - — Physician support for the Hospital and its programs
  - — Historical utilization levels
- Planning agency applications and approvals
- Construction and equipment costs, debt service requirements, and estimated financing costs
- Staffing patterns and other operating considerations

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[25] Although the entity referred to in the report is a hospital, the form of report is also applicable to other entities such as hotels or stadiums. Also, although the illustrated report format and language should not be departed from in any significant way, the language used should be tailored to fit the circumstances that are unique to a particular engagement (for example, the description of the proposed capital improvement program, paragraph *c*; the proposed financing of the program, paragraphs *b* and *d*; the specific procedures applied by the practitioner, paragraph *e*; and any explanatory comments included in emphasis-of-a-matter paragraphs, paragraph *i*, which deals with general matter; and paragraph *j*, which deals with specific matters).

- Third-party reimbursement policy and history
- Revenue/expense/volume relationships

f. We also participated in gathering other information, assisted management in identifying and formulating its assumptions, and assembled the accompanying financial forecast based on those assumptions.

g. The accompanying financial forecast for the annual periods ending December 31, 20X2, through 20X6, is based on assumptions that were provided by or reviewed with and approved by management. The financial forecast includes the following:

- Balance sheets
- Statements of operations
- Statements of cash flows
- Statements of changes in net assets

h. We have examined the financial forecast. Example Hospital's management is responsible for the forecast. Our responsibility is to express an opinion on the forecast based on our examination. Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included such procedures as we considered necessary to evaluate both the assumptions used by management and the preparation and presentation of the forecast. We believe that our examination provides a reasonable basis for our opinion.

i. Legislation and regulations at all levels of government have affected and may continue to affect revenues and expenses of hospitals. The financial forecast is based on legislation and regulations currently in effect. If future legislation or regulations related to hospital operations are enacted, such legislation or regulations could have a material effect on future operations.

j. The interest rate, principal payments, Program costs, and other financing assumptions are described in the section entitled "Summary of Significant Forecast Assumptions and Rationale." If actual interest rates, principal payments, and funding requirements are different from those assumed, the amount of the bond issue and debt service requirements would need to be adjusted accordingly from those indicated in the forecast. If such interest rates, principal payments, and funding requirements are lower than those assumed, such adjustments would not adversely affect the forecast.

k. Our conclusions are presented below.

- In our opinion, the accompanying financial forecast is presented in conformity with guidelines for presentation of a financial forecast established by the American Institute of Certified Public Accountants.
- In our opinion, the underlying assumptions provide a reasonable basis for management's forecast. However, there will usually be differences between the forecasted and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material.

- The accompanying financial forecast indicates that sufficient funds could be generated to meet the Hospital's operating expenses, working capital needs, and other financial requirements, including the debt service requirements associated with the proposed $25,000,000 bond issue, during the forecast periods. However, the achievement of any financial forecast is dependent on future events, the occurrence of which cannot be assured.

l. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

[*Signature*]

[*Date*]

Applying Agreed-Upon Procedures to Prospective Financial Statements

.51 The practitioner who accepts an engagement to apply agreed-upon procedures to prospective financial statements should follow the general, fieldwork, and reporting standards for attest engagements established in section 50, *SSAE Hierarchy*, and the guidance set forth herein and in section 201, *Agreed-Upon Procedures Engagements*. [Revised, November 2006, to reflect conforming changes necessary due to the issuance of SSAE No. 14.]

.52 A practitioner may perform an agreed-upon procedures attest engagement on prospective financial statements[26] provided the following conditions are met.

a. The practitioner is independent.

b. The practitioner and the specified parties agree upon the procedures performed or to be performed by the practitioner.

c. The specified parties take responsibility for the sufficiency of the agreed-upon procedures for their purposes.

d. The prospective financial statements include a summary of significant assumptions.

e. The prospective financial statements to which the procedures are to be applied are subject to reasonably consistent evaluation against criteria that are suitable and available to the specified parties.

f. Criteria to be used in the determination of findings are agreed upon between the practitioner and the specified parties.[27]

g. The procedures to be applied to the prospective financial statements are expected to result in reasonably consistent findings using the criteria.

h. Evidential matter related to the prospective financial statements to which the procedures are applied is expected to exist to provide a reasonable basis for expressing the findings in the practitioner's report.

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[26] Practitioners should follow the guidance in AU-C section 920, *Letters for Underwriters and Certain Other Requesting Parties*, when requested to perform agreed-upon procedures on a forecast and report thereon in a letter for an underwriter. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

[27] For example, accounting principles and other presentation criteria as discussed in chapter 8, "Presentation Guidelines," of AICPA Guide *Prospective Financial Information*.

i. Where applicable, the practitioner and the specified users agree on any agreed-upon materiality limits for reporting purposes. (See paragraph .25 of section 201.)

j. Use of the report is to be restricted to the specified parties.[28]

.53 Generally, the practitioner's procedures may be as limited or as extensive as the specified parties desire, as long as the specified parties take responsibility for their sufficiency. However, mere reading of prospective financial statements does not constitute a procedure sufficient to permit a practitioner to report on the results of applying agreed-upon procedures to such statements. (See paragraph .15 of section 201.)

.54 To satisfy the requirements that the practitioner and the specified parties agree upon the procedures performed or to be performed and that the specified parties take responsibility for the sufficiency of the agreed-upon procedures for their purposes, ordinarily the practitioner should communicate directly with and obtain affirmative acknowledgment from each of the specified parties. For example, this may be accomplished by meeting with the specified parties or by distributing a draft of the anticipated report or a copy of an engagement letter to the specified parties and obtaining their agreement. If the practitioner is not able to communicate directly with all of the specified parties, the practitioner may satisfy these requirements by applying any one or more of the following or similar procedures:

- Compare the procedures to be applied to written requirements of the specified parties.
- Discuss the procedures to be applied with appropriate representatives of the specified parties involved.
- Review relevant contracts with or correspondence from the specified parties.

The practitioner should not report on an engagement when specified parties do not agree upon the procedures performed or to be performed and do not take responsibility for the sufficiency of the procedures for their purposes. (See paragraph .36 of section 201 for guidance on satisfying these requirements when the practitioner is requested to add other parties as specified parties after the date of completion of the agreed-upon procedures.)

Reports on the Results of Applying Agreed-Upon Procedures

.55 The practitioner's report on the results of applying agreed-upon procedures should be in the form of procedures and findings. The practitioner's report should contain the following elements:

a. A title that includes the word *independent*

b. Identification of the specified parties

c. Reference to the prospective financial statements covered by the practitioner's report and the character of the engagement

d. A statement that the procedures performed were those agreed to by the specified parties identified in the report

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[28] In some cases, restricted-use reports filed with regulatory agencies are required by law or regulation to be made available to the public as a matter of public record. Also, a regulatory agency as part of its oversight responsibility for an entity may require access to restricted-use reports in which they are not named as a specified party. (See paragraph .79 of section 101.)

e. Identification of the responsible party and a statement that the prospective financial statements are the responsibility of the responsible party

f. A statement that the agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants

g. A statement that the sufficiency of the procedures is solely the responsibility of the specified parties and a disclaimer of responsibility for the sufficiency of those procedures

h. A list of the procedures performed (or reference thereto) and related findings (The practitioner should not provide negative assurance—see paragraph .24 of section 201.)

i. Where applicable, a description of any agreed-upon materiality limits (See paragraph .25 of section 201.)

j. A statement that the practitioner was not engaged to and did not conduct an examination of prospective financial statements; a disclaimer of opinion on whether the presentation of the prospective financial statements is in conformity with AICPA presentation guidelines and on whether the underlying assumptions provide a reasonable basis for the forecast, or a reasonable basis for the projection given the hypothetical assumptions; and a statement that if the practitioner had performed additional procedures, other matters might have come to his or her attention that would have been reported

k. A statement of restrictions on the use of the report because it is intended to be used solely by the specified parties

l. Where applicable, reservations or restrictions concerning procedures or findings as discussed in paragraphs .33, .35, and .39–.40 of section 201

m. A caveat that the prospective results may not be achieved

n. A statement that the practitioner assumes no responsibility to update the report for events and circumstances occurring after the date of the report

o. Where applicable, a description of the nature of the assistance provided by a specialist as discussed in paragraphs .19–.21 of section 201

p. The manual or printed signature of the practitioner's firm

q. The date of the report

.56 The following illustrates a report on applying agreed-upon procedures to the prospective financial statements. (See section 201.)

Independent Accountant's Report
on Applying Agreed-Upon Procedures

Board of Directors—XYZ Corporation

Board of Directors—ABC Company

At your request, we have performed certain agreed-upon procedures, as enumerated below, with respect to the forecasted balance sheet and the related forecasted statements of income, retained earnings, and cash flows of DEF Company, a subsidiary of ABC Company, as of December 31, 20XX, and for the year then ending. These procedures, which were agreed to by the Boards of

Directors of XYZ Corporation and ABC Company, were performed solely to assist you in evaluating the forecast in connection with the proposed sale of DEF Company to XYZ Corporation. DEF Company's management is responsible for the forecast.

This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of the specified parties. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

[*Include paragraphs to enumerate procedures and findings*.]

We were not engaged to and did not conduct an examination, the objective of which would be the expression of an opinion on the accompanying prospective financial statements. Accordingly, we do not express an opinion on whether the prospective financial statements are presented in conformity with AICPA presentation guidelines or on whether the underlying assumptions provide a reasonable basis for the presentation. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you. Furthermore, there will usually be differences between the forecasted and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

This report is intended solely for the information and use of the Boards of Directors of ABC Company and XYZ Corporation and is not intended to be and should not be used by anyone other than these specified parties.

[*Signature*]

[*Date*]

Partial Presentations

.57 The practitioner's procedures on a partial presentation may be affected by the nature of the information presented. Many elements of prospective financial statements are interrelated. The practitioner should give appropriate consideration to whether key factors affecting elements, accounts, or items that are interrelated with those in the partial presentation he or she has been engaged to examine or compile have been considered, including key factors that may not necessarily be obvious to the partial presentation (for example, productive capacity relative to a sales forecast), and whether all significant assumptions have been disclosed. The practitioner may find it necessary for the scope of the examination or compilation of some partial presentations to be similar to that for the examination or compilation of a presentation of prospective financial statements. For example, the scope of a practitioner's procedures when he or she examines forecasted results of operations would likely be similar to that of procedures used for the examination of prospective financial statements since the practitioner would most likely need to consider the interrelationships of all accounts in the examination of results of operations.

.58 Because partial presentations are generally appropriate only for limited use, reports on partial presentations of both forecasted and projected information should include a description of any limitations on the usefulness of the presentation.

Other Information

.59 When a practitioner's compilation, review, or audit report on historical financial statements is included in a practitioner-submitted document containing prospective financial statements, the practitioner should either examine, compile, or apply agreed-upon procedures to the prospective financial statements and report accordingly, unless the following occur.

a. The prospective financial statements are labeled as a "budget."

b. The budget does not extend beyond the end of the current fiscal year.

c. The budget is presented with interim historical financial statements for the current year.

In such circumstances, the practitioner need not examine, compile, or apply agreed-upon procedures to the budget; however, he or she should report on it and—

a. Indicate that he or she did not examine or compile the budget.

b. Disclaim an opinion or any other form of assurance on the budget.

In addition, the budgeted information may omit the summaries of significant assumptions and accounting policies required by the guidelines for presentation of prospective financial statements established by the AICPA, provided such omission is not, to the practitioner's knowledge, undertaken with the intention of misleading those who might reasonably be expected to use such budgeted information, and is disclosed in the practitioner's report. The following is the form of the standard paragraphs to be added to the practitioner's report in this circumstance when the summaries of significant assumptions and accounting policies have been omitted.

> The accompanying budgeted balance sheet, statements of income, retained earnings, and cash flows of XYZ Company as of December 31, 20XX, and for the six months then ending, have not been compiled or examined by us, and, accordingly, we do not express an opinion or any other form of assurance on them.
>
> Management has elected to omit the summaries of significant assumptions and accounting policies required under established guidelines for presentation of prospective financial statements. If the omitted summaries were included in the budgeted information, they might influence the user's conclusions about the company's budgeted information. Accordingly, this budgeted information is not designed for those who are not informed about such matters.

.60 When the practitioner's compilation, review, or audit report on historical financial statements is included in a client-prepared document containing prospective financial statements, the practitioner should not consent to the use of his or her name in the document unless:

a. He or she has examined, compiled, or applied agreed-upon procedures to the prospective financial statements and his or her report accompanies them.

b. The prospective financial statements are accompanied by an indication by the responsible party or the practitioner that the practitioner has not performed such a service on the prospective financial statements and that the practitioner assumes no responsibility for them.

c. Another practitioner has examined, compiled, or applied agreed-upon procedures to the prospective financial statements and his or her report is included in the document.

In addition, if the practitioner has audited the historical financial statements and the prospective financial statements that he or she did not examine, compile, or apply agreed-upon procedures to are included in a document containing the audited historical financial statements and the auditor's report thereon,[29] he or she should refer to AU-C section 720, *Other Information in Documents Containing Audited Financial Statements*. [Revised, December 2010, to reflect conforming changes necessary due to the issuance of SAS Nos. 118–120. Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.61 The practitioner whose report on prospective financial statements is included in a client-prepared document containing historical financial statements should not consent to the use of his or her name in the document unless:

a. He or she has compiled, reviewed, or audited the historical financial statements and his or her report accompanies them.

b. The historical financial statements are accompanied by an indication by the responsible party or the practitioner that the practitioner has not performed such a service on the historical financial statements and that the practitioner assumes no responsibility for them.

c. Another practitioner has compiled, reviewed, or audited the historical financial statements and his or her report is included in the document.

.62 An entity may publish various documents that contain information other than historical financial statements in addition to the compiled or examined prospective financial statements and the practitioner's report thereon. The practitioner's responsibility with respect to information in such a document does not extend beyond the financial information identified in the report, and he or she has no obligation to perform any procedures to corroborate other information contained in the document. However, the practitioner should read the other information and consider whether such information, or the manner of its presentation, is materially inconsistent with the information, or manner of its presentation, appearing in the prospective financial statements.

.63 If the practitioner examines prospective financial statements included in a document containing inconsistent information, he or she might not be able to conclude that there is adequate support for each significant assumption. The practitioner should consider whether the prospective financial statements, his or her report, or both require revision. Depending on the conclusion he or she reaches, the practitioner should consider other actions that may be appropriate, such as issuing an adverse opinion, disclaiming an opinion because of a scope limitation, withholding the use of his or her report in the document, or withdrawing from the engagement.

.64 If the practitioner compiles the prospective financial statements included in the document containing inconsistent information, he or she should attempt to obtain additional or revised information. If he or she does not receive

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[29] AU-C section 720 applies only to such prospective financial statements contained in annual reports (or similar documents) that are issued to owners (or similar stakeholders) and annual reports of governments and organizations for charitable or philanthropic purposes that are available to the public that contain audited financial statements and the auditor's report thereon. AU-C section 720 also may be applied, adapted as necessary in the circumstances, to other documents to which the auditor, at management's request, devotes attention. AU-C section 720 does not apply when the historical financial statements and report appear in a registration statement filed under the Securities Act of 1933 (in which case, see AU-C section 925, *Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933*). [Footnote revised, December 2010, to reflect conforming changes necessary due to the issuance of SAS Nos. 118–120. Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

such information, the practitioner should withhold the use of his or her report or withdraw from the compilation engagement.

.65 If, while reading the other information appearing in the document containing the examined or compiled prospective financial statements, as described in the preceding paragraphs, the practitioner becomes aware of information that he or she believes is a material misstatement of fact that is not an inconsistent statement, he or she should discuss the matter with the responsible party. In connection with this discussion, the practitioner should consider that he or she may not have the expertise to assess the validity of the statement made, that there may be no standards by which to assess its presentation, and that there may be valid differences of judgment or opinion. If the practitioner concludes that he or she has a valid basis for concern, he or she should propose that the responsible party consult with some other party whose advice might be useful, such as the entity's legal counsel.

.66 If, after discussing the matter as described in paragraph .65, the practitioner concludes that a material misstatement of fact remains, the action he or she takes will depend on his or her judgment in the particular circumstances. The practitioner should consider steps such as notifying the responsible party in writing of his or her views concerning the information and consulting his or her legal counsel about further appropriate action in the circumstances.

Effective Date

.67 This section is effective when the date of the practitioner's report is on or after June 1, 2001. Early application is permitted.

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Appendix A

Minimum Presentation Guidelines[*]

1. Prospective information presented in the format of historical financial statements facilitates comparisons with financial position, results of operations, and cash flows of prior periods, as well as those actually achieved for the prospective period. Accordingly, prospective financial statements preferably should be in the format of the historical financial statements that would be issued for the period(s) covered unless there is an agreement between the responsible party and potential users specifying another format. Prospective financial statements may take the form of complete basic financial statements[1] or may be limited to the following minimum items (where such items would be presented for historical financial statements for the period).[2]

a. Sales or gross revenues

b. Gross profit or cost of sales

c. Unusual or infrequently occurring items

d. Provision for income taxes

e. Discontinued operations or extraordinary items

f. Income from continuing operations

g. Net income

h. Basic and diluted earnings per share

i. Significant changes in financial position[3]

j. A description of what the responsible party intends the prospective financial statements to present, a statement that the assumptions are based on the responsible party's judgment at the time the prospective information was prepared, and a caveat that the prospective results may not be achieved

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[*] ***Note:*** This appendix describes the minimum items that constitute a presentation of a financial forecast or a financial projection, as specified in AICPA Guide *Prospective Financial Information*. Complete presentation guidelines for entities that choose to issue prospective financial statements, together with illustrative presentations, are included in the Guide. The guide also prescribes presentation guidelines for partial presentations.

[1] The details of each statement may be summarized or condensed so that only the major items in each are presented. The usual footnotes associated with historical financial statements need not be included as such. However, significant assumptions and accounting policies should be disclosed.

[2] Similar types of financial information should be presented for entities for which these terms do not describe operations. Further, similar items should be presented if a comprehensive basis of accounting other than GAAP is used to present the prospective financial statements. For example, if the cash basis were used, item a would be cash receipts.

[3] The responsible party should disclose significant cash flows and other significant changes in balance sheet accounts during the period. However, neither a balance sheet nor a statement of cash flows, as described in Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 230, *Statement of Cash Flows*, is required. Furthermore, none of the specific captions or disclosures required by FASB ASC 230 is required. Significant changes disclosed will depend on the circumstances; however, such disclosures will often include cash flows from operations. See AICPA Guide *Prospective Financial Information* exhibits 9-2 and 9-6 for illustrations of alternate methods of presenting significant cash flows. [Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

k. Summary of significant assumptions

l. Summary of significant accounting policies

2. A presentation that omits one or more of the applicable minimum items *a–i* is a partial presentation, which would not ordinarily be appropriate for general use. If an omitted applicable minimum item is derivable from the information presented, the presentation would not be deemed to be a partial presentation. A presentation that contains the applicable minimum items *a–i*, but omits items *j–l*, is subject to all of the provisions of this section applicable to complete presentations.

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Appendix B

Training and Proficiency, Planning, and Procedures Applicable to Compilations

Training and Proficiency

1. The practitioner should be familiar with the guidelines for the preparation and presentation of prospective financial statements. The guidelines are contained in AICPA Guide *Prospective Financial Information*.

2. The practitioner should possess or obtain a level of knowledge of the industry and the accounting principles and practices of the industry in which the entity operates or will operate that will enable him or her to compile prospective financial statements that are in appropriate form for an entity operating in that industry.

Planning the Compilation Engagement

3. To compile the prospective financial statements of an existing entity, the practitioner should obtain a general knowledge of the nature of the entity's business transactions and the key factors upon which its future financial results appear to depend. He or she should also obtain an understanding of the accounting principles and practices of the entity to determine whether they are comparable to those used within the industry in which the entity operates.

4. To compile the prospective financial statements of a proposed entity, the practitioner should obtain knowledge of the proposed operations and the key factors upon which its future results appear to depend and that have affected the performance of entities in the same industry.

Compilation Procedures

5. In a compilation of prospective financial statements the practitioner should perform the following, where applicable.

a. Establish an understanding with the client regarding the services to be performed. The understanding should include the objectives of the engagement, the client's responsibilities, the practitioner's responsibilities, and limitations of the engagement. The practitioner should document the understanding in the working papers, preferably through a written communication with the client. If the practitioner believes an understanding with the client has not been established, he or she should decline to accept or perform the engagement.

b. Inquire about the accounting principles used in the preparation of the prospective financial statements.

(1) For existing entities, compare the accounting principles used to those used in the preparation of previous historical financial statements and inquire whether such principles are the same as those expected to be used in the historical financial statements covering the prospective period.

(2) For entities to be formed or entities formed that have not commenced operations, compare specialized industry accounting principles used, if any, to those typically used in the industry. Inquire whether the accounting principles used for the prospective financial statements are those that are expected to be used when or if the entity commences operations.

c. Ask how the responsible party identifies the key factors and develops its assumptions.

d. List, or obtain a list of the responsible party's significant assumptions providing the basis for the prospective financial statements and consider whether there are any obvious omissions in light of the key factors upon which the prospective results of the entity appear to depend.

e. Consider whether there appear to be any obvious internal inconsistencies in the assumptions.

f. Perform or test the mathematical accuracy of the computations that translate the assumptions into prospective financial statements.

g. Read the prospective financial statements, including the summary of significant assumptions, and consider whether—

(1) The statements, including the disclosures of assumptions and accounting policies, appear to be not presented in conformity with the AICPA presentation guidelines for prospective financial statements.[1]

(2) The statements, including the summary of significant assumptions, appear to be not obviously inappropriate in relation to the practitioner's knowledge of the entity and its industry and, for the following:

(a) *Financial forecast*, the expected conditions and course of action in the prospective period

(b) *Financial projection*, the purpose of the presentation

h. If a significant part of the prospective period has expired, inquire about the results of operations or significant portions of the operations (such as sales volume), and significant changes in financial position, and consider their effect in relation to the prospective financial statements. If historical financial statements have been prepared for the expired portion of the period, the practitioner should read such statements and consider those results in relation to the prospective financial statements.

i. Confirm his or her understanding of the statements (including assumptions) by obtaining written representations from the responsible party. Because the amounts reflected in the statements are not supported by historical books and records but rather by assumptions, the practitioner should obtain representations in which the responsible party indicates its responsibility for the assumptions. The representations should be signed by the responsible party at the highest

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[1] Presentation guidelines for entities that issue prospective financial statements are set forth and illustrated in AICPA Guide *Prospective Financial Information*.

level of authority who the practitioner believes is responsible for and knowledgeable, directly or through others, about matters covered by the representations.

(1) For a *financial forecast*, the representations should include the responsible party's assertion that the financial forecast presents, to the best of its knowledge and belief, the expected financial position, results of operations, and cash flows for the forecast period and that the forecast reflects the responsible party's judgment, based on present circumstances, of the expected conditions and its expected course of action. The representations should also include a statement that the forecast is presented in conformity with guidelines for presentation of a forecast established by the American Institute of Certified Public Accountants. The representations should also include a statement that the assumptions on which the forecast is based are reasonable. If the forecast contains a range, the representation should also include a statement that, to the best of the responsible party's knowledge and belief, the item or items subject to the assumption are expected to actually fall within the range and that the range was not selected in a biased or misleading manner.

(2) For a *financial projection*, the representations should include the responsible party's assertion that the financial projection presents, to the best of its knowledge and belief, the expected financial position, results of operations, and cash flows for the projection period given the hypothetical assumptions, and that the projection reflects its judgment, based on present circumstances, of expected conditions and its expected course of action given the occurrence of the hypothetical events. The representations should also (*i*) identify the hypothetical assumptions and describe the limitations on the usefulness of the presentation, (*ii*) state that the assumptions are appropriate, (*iii*) indicate if the hypothetical assumptions are improbable, and (*iv*) if the projection contains a range, include a statement that, to the best of the responsible party's knowledge and belief, given the hypothetical assumptions, the item or items subject to the assumption are expected to actually fall within the range and that the range was not selected in a biased or misleading manner. The representations should also include a statement that the projection is presented in conformity with guidelines for presentation of a projection established by the American Institute of Certified Public Accountants.

j. Consider, after applying the preceding procedures, whether he or she has received representations or other information that appears to be obviously inappropriate, incomplete, or otherwise misleading and, if so, attempt to obtain additional or revised information. If he or she does not receive such information, the practitioner should ordinarily withdraw from the compilation engagement.[2] (Note that the omission of disclosures, other than those relating to significant assumptions, would not require the practitioner to withdraw; see paragraph .26.)

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[2] The practitioner need not withdraw from the engagement if the effect of such information on the prospective financial statements does not appear to be material.

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Appendix C

Training and Proficiency, Planning, and Procedures Applicable to Examinations

Training and Proficiency

1. The practitioner should be familiar with the guidelines for the preparation and presentation of prospective financial statements. The guidelines are contained in AICPA Guide *Prospective Financial Information*.

2. The practitioner should possess or obtain a level of knowledge of the industry and the accounting principles and practices of the industry in which the entity operates or will operate that will enable him or her to examine prospective financial statements that are in appropriate form for an entity operating in that industry.

Planning an Examination Engagement

3. Planning the examination engagement involves developing an overall strategy for the expected scope and conduct of the engagement. To develop such a strategy, the practitioner needs to have sufficient knowledge to enable him or her to adequately understand the events, transactions, and practices that, in his or her judgment, may have a significant effect on the prospective financial statements.

4. Factors to be considered by the practitioner in planning the examination include the following:

a. The accounting principles to be used and the type of presentation

b. The anticipated level of attestation risk related to the prospective financial statements[1]

c. Preliminary judgments about materiality levels

d. Items within the prospective financial statements that are likely to require revision or adjustment

e. Conditions that may require extension or modification of the practitioner's examination procedures

f. Knowledge of the entity's business and its industry

g. The responsible party's experience in preparing prospective financial statements

h. The length of the period covered by the prospective financial statements

i. The process by which the responsible party develops its prospective financial statements

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[1] *Attestation* risk is the risk that the practitioner may unknowingly fail to appropriately modify his or her examination report on prospective financial statements that are materially misstated, that is, that are not presented in conformity with AICPA presentation guidelines or have assumptions that do not provide a reasonable basis for management's forecast, or management's projection given the hypothetical assumptions. It consists of (*a*) the risk (consisting of *inherent risk* and *control risk*) that the prospective financial statements contain errors that could be material and (*b*) the risk (*detection risk*) that the practitioner will not detect such errors.

5. The practitioner should obtain knowledge of the entity's business, accounting principles, and the key factors upon which its future financial results appear to depend. The practitioner should focus on areas such as the following:

a. The availability and cost of resources needed to operate (Principal items usually include raw materials, labor, short-term and long-term financing, and plant and equipment.)

b. The nature and condition of markets in which the entity sells its goods or services, including final consumer markets if the entity sells to intermediate markets

c. Factors specific to the industry, including competitive conditions, sensitivity to economic conditions, accounting policies, specific regulatory requirements, and technology

d. Patterns of past performance for the entity or comparable entities, including trends in revenue and costs, turnover of assets, uses and capacities of physical facilities, and management policies

Examination Procedures

6. The practitioner should establish an understanding with the responsible party regarding the services to be performed. The understanding should include the objectives of the engagement, the responsible party's responsibilities, the practitioner's responsibilities, and limitations of the engagement. The practitioner should document the understanding in the working papers, preferably through a written communication with the responsible party. If the practitioner believes an understanding with the responsible party has not been established, he or she should decline to accept or perform the engagement. If the responsible party is different than the client, the practitioner should establish the understanding with both the client and the responsible party, and the understanding also should include the client's responsibilities.

7. The practitioner's objective in an examination of prospective financial statements is to accumulate sufficient evidence to restrict attestation risk to a level that is, in his or her professional judgment, appropriate for the level of assurance that may be imparted by his or her examination report. In a report on an examination of prospective financial statements, the practitioner provides assurance only about whether the prospective financial statements are presented in conformity with AICPA presentation guidelines and whether the assumptions provide a reasonable basis for management's forecast, or a reasonable basis for management's projection given the hypothetical assumptions. He or she does not provide assurance about the achievability of the prospective results because events and circumstances frequently do not occur as expected and achievement of the prospective results is dependent on the actions, plans, and assumptions of the responsible party.

8. In his or her examination of prospective financial statements, the practitioner should select from all available procedures—that is, procedures that assess inherent and control risk and restrict detection risk—any combination that can restrict attestation risk to such an appropriate level. The extent to which examination procedures will be performed should be based on the practitioner's consideration of the following:

a. The nature and materiality of the information to the prospective financial statements taken as a whole

b. The likelihood of misstatements

c. Knowledge obtained during current and previous engagements

d. The responsible party's competence with respect to prospective financial statements

e. The extent to which the prospective financial statements are affected by the responsible party's judgment, for example, its judgment in selecting the assumptions used to prepare the prospective financial statements

f. The adequacy of the responsible party's underlying data

9. The practitioner should perform those procedures he or she considers necessary in the circumstances to report on whether the assumptions provide a reasonable basis for the following.

a. *Financial forecast.* The practitioner can form an opinion that the assumptions provide a reasonable basis for the forecast if the responsible party represents that the presentation reflects, to the best of its knowledge and belief, its estimate of expected financial position, results of operations, and cash flows for the prospective period[2] and the practitioner concludes, based on his or her examination, (*i*) that the responsible party has explicitly identified all factors expected to materially affect the operations of the entity during the prospective period and has developed appropriate assumptions with respect to such factors[3] and (*ii*) that the assumptions are suitably supported.

b. *Financial projection given the hypothetical assumptions.* The practitioner can form an opinion that the assumptions provide a reasonable basis for the financial projection given the hypothetical assumptions if the responsible party represents that the presentation reflects, to the best of its knowledge and belief, expected financial position, results of operations, and cash flows for the prospective period given the hypothetical assumptions[4] and the practitioner concludes, based on his or her examination, that:

(1) The responsible party has explicitly identified all factors that would materially affect the operations of the entity during the prospective period if the hypothetical assumptions were to materialize and has developed appropriate assumptions with respect to such factors and

(2) The other assumptions are suitably supported given the hypothetical assumptions. However, as the number and significance of the hypothetical assumptions increase, the practitioner may not be able to satisfy himself or herself about the presentation as a whole by obtaining support for the remaining assumptions.

10. The practitioner should evaluate the support for the assumptions.

a. *Financial forecast*—The practitioner can conclude that assumptions are suitably supported if the preponderance of information supports each significant assumption.

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[2] If the forecast contains a range, the representation should also include a statement that, to the best of the responsible party's knowledge and belief, the item or items subject to the assumption are expected to actually fall within the range and that the range was not selected in a biased or misleading manner.

[3] An attempt to list all assumptions is inherently not feasible. Frequently, basic assumptions that have enormous potential impact are considered to be implicit, such as conditions of peace and absence of natural disasters.

[4] If the projection contains a range, the representation should also include a statement that, to the best of the responsible party's knowledge and belief, given the hypothetical assumptions, the item or items subject to the assumption are expected to actually fall within the range and that the range was not selected in a biased or misleading manner.

b. *Financial projection*—In evaluating support for assumptions other than hypothetical assumptions, the practitioner can conclude that they are suitably supported if the preponderance of information supports each significant assumption given the hypothetical assumptions. The practitioner need not obtain support for the hypothetical assumptions, although he or she should consider whether they are consistent with the purpose of the presentation.

11. In evaluating the support for assumptions, the practitioner should consider—

a. Whether sufficient pertinent sources of information about the assumptions have been considered. Examples of external sources the practitioner might consider are government publications, industry publications, economic forecasts, existing or proposed legislation, and reports of changing technology. Examples of internal sources are budgets, labor agreements, patents, royalty agreements and records, sales backlog records, debt agreements, and actions of the board of directors involving entity plans.

b. Whether the assumptions are consistent with the sources from which they are derived.

c. Whether the assumptions are consistent with each other.

d. Whether the historical financial information and other data used in developing the assumptions are sufficiently reliable for that purpose. Reliability can be assessed by inquiry and analytical or other procedures, some of which may have been completed in past audits or reviews of the historical financial statements. If historical financial statements have been prepared for an expired part of the prospective period, the practitioner should consider the historical data in relation to the prospective results for the same period, where applicable. If the prospective financial statements incorporate such historical financial results and that period is significant to the presentation, the practitioner should make a review of the historical information in conformity with the applicable standards for a review.[5]

e. Whether the historical financial information and other data used in developing the assumptions are comparable over the periods specified or whether the effects of any lack of comparability were considered in developing the assumptions.

f. Whether the logical arguments or theory, considered with the data supporting the assumptions, are reasonable.

12. In evaluating the preparation and presentation of the prospective financial statements, the practitioner should perform procedures that will provide reasonable assurance as to the following.

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[5] If the entity is an issuer, the practitioner should perform the procedures in paragraphs .13–.19 of AU section 722, *Interim Financial Information* (AICPA, *PCAOB Standards and Related Rules*, Interim Standards). If the entity is a nonissuer, the practitioner should perform the procedures in AR section 90, *Review of Financial Statements*, or in AU-C section 930, *Interim Financial Information*, when the review of interim financial information meets the provisions of that section. [Footnote revised, November 2002, to reflect conforming changes necessary due to the issuance of SAS No. 100 and SSARS No. 9. Footnote revised, May 2004, to reflect the conforming changes necessary due to the issuance of SSARS No. 10. Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126 and SSARS No. 19.]

a. The presentation reflects the identified assumptions.

b. The computations made to translate the assumptions into prospective amounts are mathematically accurate.

c. The assumptions are internally consistent.

d. Accounting principles used in the—

(1) Financial forecast are consistent with the accounting principles expected to be used in the historical financial statements covering the prospective period and those used in the most recent historical financial statements, if any.

(2) Financial projection are consistent with the accounting principles expected to be used in the prospective period and those used in the most recent historical financial statements, if any, or that they are consistent with the purpose of the presentation.[6]

e. The presentation of the prospective financial statements follows the AICPA guidelines applicable for such statements.[7]

f. The assumptions have been adequately disclosed based on AICPA presentation guidelines for prospective financial statements.

13. The practitioner should consider whether the prospective financial statements, including related disclosures, should be revised because of any of the following:

a. Mathematical errors

b. Unreasonable or internally inconsistent assumptions

c. Inappropriate or incomplete presentation

d. Inadequate disclosure

14. The practitioner should obtain written representations from the responsible party acknowledging its responsibility for both the presentation and the underlying assumptions. The representations should be signed by the responsible party at the highest level of authority who the practitioner believes is responsible for and knowledgeable, directly or through others in the organization, about the matters covered by the representations. Paragraph .69, subparagraph 5*i* describes the specific representations to be obtained for a financial forecast and a financial projection. See paragraph .43 for guidance on the form of report to be rendered if the practitioner is not able to obtain the required representations.

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[6] The accounting principles used in a financial projection need not be those expected to be used in the historical financial statements for the prospective period if use of different principles is consistent with the purpose of the presentation.

[7] Presentation guidelines for entities that issue prospective financial statements are set forth and illustrated in AICPA Guide *Prospective Financial Information*.

AT Section 401

Reporting on Pro Forma Financial Information

Source: SSAE No. 10.

Effective when the presentation of pro forma financial information is as of or for a period ending on or after June 1, 2001. Earlier application is permitted.

Introduction

.01 This section provides guidance to a practitioner who is engaged to issue or does issue an examination or a review report on pro forma financial information. Such an engagement should comply with the general and fieldwork standards established in section 50, *SSAE Hierarchy*, and the specific performance and reporting standards set forth in this section.[1] [Revised, November 2006, to reflect conforming changes necessary due to the issuance of SSAE No. 14.]

.02 When pro forma financial information is presented outside the basic financial statements but within the same document, and the practitioner is not engaged to report on the pro forma financial information, the practitioner's responsibilities are described in AU-C section 720, *Other Information in Documents Containing Audited Financial Statements*, and AU-C section 925, *Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933*. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.03 This section does not apply in those circumstances when, for purposes of a more meaningful presentation, a transaction consummated after the balance-sheet date is reflected in the historical financial statements (such as a revision of debt maturities or a revision of earnings per share calculations for a stock split). [2]

Presentation of Pro Forma Financial Information

.04 The objective of pro forma financial information is to show what the significant effects on historical financial information might have been had a consummated or proposed transaction (or event) occurred at an earlier date. Pro forma financial information is commonly used to show the effects of transactions such as the following:

- Business combination
- Change in capitalization

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[1] Paragraph .10 of AU-C section 920, *Letters for Underwriters and Certain Other Requesting Parties*, identifies certain parties who may request a letter. When one of those parties requests a letter or asks the practitioner to perform agreed-upon procedures on pro forma financial information in connection with an offering, the practitioner should follow the guidance in paragraphs .10, .13, .44, and .52–.53 of AU-C section 920. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

[2] In certain circumstances, generally accepted accounting principles may require the presentation of pro forma financial information in the financial statements or the accompanying notes. That information includes, for example, pro forma financial information required by Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 805, *Business Combinations*, or FASB ASC 250, *Accounting Changes and Error Corrections*. [Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC. Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

- Disposition of a significant portion of the business
- Change in the form of business organization or status as an autonomous entity
- Proposed sale of securities and the application of the proceeds

.05 This objective is achieved primarily by applying pro forma adjustments to historical financial information. Pro forma adjustments should be based on management's assumptions and give effect to all significant effects directly attributable to the transaction (or event).

.06 Pro forma financial information should be labeled as such to distinguish it from historical financial information. This presentation should describe the transaction (or event) that is reflected in the pro forma financial information, the source of the historical financial information on which it is based, the significant assumptions used in developing the pro forma adjustments, and any significant uncertainties about those assumptions. The presentation also should indicate that the pro forma financial information should be read in conjunction with related historical financial information and that the pro forma financial information is not necessarily indicative of the results (such as financial position and results of operations, as applicable) that would have been attained had the transaction (or event) actually taken place earlier.[3]

Conditions for Reporting

.07 The practitioner may agree to report on an examination or a review of pro forma financial information if the following conditions are met.

a. The document that contains the pro forma financial information includes (or incorporates by reference) complete historical financial statements of the entity for the most recent year (or for the preceding year if financial statements for the most recent year are not yet available) and, if pro forma financial information is presented for an interim period, the document also includes (or incorporates by reference) historical interim financial information for that period (which may be presented in condensed form).[4] In the case of a business combination, the document should include (or incorporate by reference) the appropriate historical financial information for the significant constituent parts of the combined entity.

b. The historical financial statements of the entity (or, in the case of a business combination, of each significant constituent part of the combined entity) on which the pro forma financial information is based have been audited or reviewed.[5] The practitioner's attestation risk

[3] For further guidance on the presentation of pro forma financial information included in filings with the Securities and Exchange Commission (SEC), see Article 11 of Regulation S-X.

[4] For pro forma financial information included in an SEC Form 8-K, historical financial information previously included in an SEC filing would meet this requirement. Interim historical financial information may be presented as a column in the pro forma financial information.

[5] The practitioner's audit or review report should be included (or incorporated by reference) in the document containing the pro forma financial information. For issuers, the review may be that as defined in AU section 722, *Interim Financial Information* (AICPA, *PCAOB Standards and Related Rules*, Interim Standards). For nonissuers, the review may be that as defined in AR section 90, *Review of Financial Statements*, or in AU-C section 930, *Interim Financial Information*, when the review of interim financial information meets the provisions of that section. [Footnote revised, November 2002, to reflect conforming changes necessary due to the issuance of SAS No. 100. Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126 and SSARS No. 19.]

relating to the pro forma financial information is affected by the scope of the engagement providing the practitioner with assurance about the underlying historical financial information to which the pro forma adjustments are applied. Therefore, the level of assurance given by the practitioner on the pro forma financial information, as of a particular date or for a particular period, should be limited to the level of assurance provided on the historical financial statements (or, in the case of a business combination, the lowest level of assurance provided on the underlying historical financial statements of any significant constituent part of the combined entity). For example, if the underlying historical financial statements of each constituent part of the combined entity have been audited at year-end and reviewed at an interim date, the practitioner may perform an examination or a review of the pro forma financial information at year-end but is limited to performing a review of the pro forma financial information at the interim date.

c. The practitioner who is reporting on the pro forma financial information should have an appropriate level of knowledge of the accounting and financial reporting practices of each significant constituent part of the combined entity. This would ordinarily have been obtained by the practitioner auditing or reviewing historical financial statements of each entity for the most recent annual or interim period for which the pro forma financial information is presented. If another practitioner has performed such an audit or a review, the need, by a practitioner reporting on the pro forma financial information, for an understanding of the entity's accounting and financial reporting practices is not diminished, and that practitioner should consider whether, under the particular circumstances, he or she can acquire sufficient knowledge of these matters to perform the procedures necessary to report on the pro forma financial information.

Practitioner's Objective

.08 The objective of the practitioner's examination procedures applied to pro forma financial information is to provide reasonable assurance as to whether—

- Management's assumptions provide a reasonable basis for presenting the significant effects directly attributable to the underlying transaction (or event).
- The related pro forma adjustments give appropriate effect to those assumptions.
- The pro forma column reflects the proper application of those adjustments to the historical financial statements.

.09 The objective of the practitioner's review procedures applied to pro forma financial information is to provide negative assurance as to whether any information came to the practitioner's attention to cause him or her to believe that—

- Management's assumptions do not provide a reasonable basis for presenting the significant effects directly attributable to the underlying transaction (or event).
- The related pro forma adjustments do not give appropriate effect to those assumptions.

- The pro forma column does not reflect the proper application of those adjustments to the historical financial statements.

Procedures

.10 Other than the procedures applied to the historical financial statements,[6] the procedures the practitioner should apply to the assumptions and pro forma adjustments for either an examination or a review engagement are as follows.

a. Obtain an understanding of the underlying transaction (or event), for example, by reading relevant contracts and minutes of meetings of the board of directors and by making inquiries of appropriate officials of the entity, and, in cases, of the entity acquired or to be acquired.

b. Obtain a level of knowledge of each constituent part of the combined entity in a business combination that will enable the practitioner to perform the required procedures. Procedures to obtain this knowledge may include communicating with other practitioners who have audited or reviewed the historical financial information on which the pro forma financial information is based. Matters that may be considered include accounting principles and financial reporting practices followed, transactions between the entities, and material contingencies.

c. Discuss with management their assumptions regarding the effects of the transaction (or event).

d. Evaluate whether pro forma adjustments are included for all significant effects directly attributable to the transaction (or event).

e. Obtain sufficient evidence in support of such adjustments. The evidence required to support the level of assurance given is a matter of professional judgment. The practitioner typically would obtain more evidence in an examination engagement than in a review engagement. Examples of evidence that the practitioner might consider obtaining are purchase, merger or exchange agreements, appraisal reports, debt agreements, employment agreements, actions of the board of directors, and existing or proposed legislation or regulatory actions.

f. Evaluate whether management's assumptions that underlie the pro forma adjustments are presented in a sufficiently clear and comprehensive manner. Also, evaluate whether the pro forma adjustments are consistent with each other and with the data used to develop them.

g. Determine that computations of pro forma adjustments are mathematically correct and that the pro forma column reflects the proper application of those adjustments to the historical financial statements.

h. Obtain written representations from management concerning their—

  - Responsibility for the assumptions used in determining the pro forma adjustments

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[6] See paragraph .07*b*.

- Assertion that the assumptions provide a reasonable basis for presenting all of the significant effects directly attributable to the transaction (or event), that the related pro forma adjustments give appropriate effect to those assumptions, and that the pro forma column reflects the proper application of those adjustments to the historical financial statements

- Assertion that the significant effects directly attributable to the transaction (or event) are appropriately disclosed in the pro forma financial information

i. Read the pro forma financial information and evaluate whether—

- The underlying transaction (or event), the pro forma adjustments, the significant assumptions and the significant uncertainties, if any, about those assumptions have been appropriately described.

- The source of the historical financial information on which the pro forma financial information is based has been appropriately identified.

Reporting on Pro Forma Financial Information

.11 The practitioner's report on pro forma financial information should be dated as of the completion of the appropriate procedures. The practitioner's report on pro forma financial information may be added to the practitioner's report on historical financial information, or it may appear separately. If the reports are combined and the date of completion of the procedures for the examination or review of the pro forma financial information is after the date of completion of the fieldwork for the audit or review of the historical financial information, the combined report should be dual-dated. (For example, "February 15, 20X2, except for the paragraphs regarding pro forma financial information as to which the date is March 20, 20X2.")

.12 A practitioner's examination report on pro forma financial information should include the following:

a. A title that includes the word *independent*

b. An identification of the pro forma financial information

c. A reference to the financial statements from which the historical financial information is derived and a statement that such financial statements were audited (The report on pro forma financial information should refer to any modification in the practitioner's report on the historical financial information.)

d. An identification of the responsible party and a statement that the responsible party is responsible for the pro forma financial information

e. A statement that the practitioner's responsibility is to express an opinion on the pro forma financial information based on his or her examination *f.* A statement that the examination of the pro forma financial information was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included such procedures as the practitioner considered necessary in the circumstances

g. A statement that the practitioner believes that the examination provides a reasonable basis for his or her opinion

h. A separate paragraph explaining the objective of pro forma financial information and its limitations

i. The practitioner's opinion as to whether management's assumptions provide a reasonable basis for presenting the significant effects directly attributable to the transaction (or event), whether the related pro forma adjustments give appropriate effect to those assumptions, and whether the pro forma column reflects the proper application of those adjustments to the historical financial statements (see paragraphs .18 and .20)

j. The manual or printed signature of the practitioner's firm

k. The date of the examination report

.13 A practitioner's review report on pro forma financial information should include the following:

a. A title that includes the word *independent*

b. An identification of the pro forma financial information

c. A reference to the financial statements from which the historical financial information is derived and a statement as to whether such financial statements were audited or reviewed (The report on pro forma financial information should refer to any modification in the practitioner's report on the historical financial information.)

d. An identification of the responsible party and a statement that the responsible party is responsible for the pro forma financial information

e. A statement that the review of the pro forma financial information was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants

f. A statement that a review is substantially less in scope than an examination, the objective of which is the expression of an opinion on the pro forma financial information and, accordingly, the practitioner does not express such an opinion

g. A separate paragraph explaining the objective of pro forma financial information and its limitations

h. The practitioner's conclusion as to whether any information came to the practitioner's attention to cause him or her to believe that management's assumptions do not provide a reasonable basis for presenting the significant effects directly attributable to the transaction (or event), or that the related pro forma adjustments do not give appropriate effect to those assumptions, or that the pro forma column does not reflect the proper application of those adjustments to the historical financial statements (See paragraphs .19–.20.)

i. The manual or printed signature of the practitioner's firm

j. The date of the review report

.14 Nothing precludes the practitioner from restricting the use of the report (see paragraphs .78–.83 of section 101).

.15 Because a pooling-of-interests business combination is accounted for by combining historical amounts retroactively, pro forma adjustments for a proposed transaction generally affect only the equity section of the pro forma condensed balance sheet. Further, because of the requirements of Financial Accounting Standards Board *Accounting Standards Codification* 805, *Business Combinations*, a business combination effected as a pooling of interests would not ordinarily involve a choice of assumptions by management. Accordingly, a report on a proposed pooling transaction need not address management's assumptions unless the pro forma financial information includes adjustments to conform the accounting principles of the combining entities. (See paragraph .21.) [Revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

.16 Restrictions on the scope of the engagement (see paragraphs .73–.75 of section 101), reservations about the propriety of the assumptions and the conformity of the presentation with those assumptions (including adequate disclosure of significant matters), or other reservations may require the practitioner to qualify the opinion, disclaim an opinion, or withdraw from the engagement.[7] The practitioner should disclose all substantive reasons for any report modifications. Uncertainty as to whether the transaction (or event) will be consummated would not ordinarily require a report modification. (See paragraph .22.)

Effective Date

.17 This section is effective when the presentation of pro forma financial information is as of or for a period ending on or after June 1, 2001. Early application is permitted.

[7] See paragraphs .76–.77 of section 101.

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Appendix A

Report on Examination of Pro Forma Financial Information

Independent Accountant's Report

We have examined the pro forma adjustments reflecting the transaction [*or event*] described in Note 1 and the application of those adjustments to the historical amounts in [*the assembly of*][8] the accompanying pro forma financial condensed balance sheet of X Company as of December 31, 20X1, and the pro forma condensed statement of income for the year then ended. The historical condensed financial statements are derived from the historical financial statements of X Company, which were audited by us, and of Y Company, which were audited by other accountants,[9] appearing elsewhere herein [*or incorporated by reference*].[10] Such pro forma adjustments are based upon management's assumptions described in Note 2. X Company's management is responsible for the pro forma financial information. Our responsibility is to express an opinion on the pro forma financial information based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included such procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

The objective of this pro forma financial information is to show what the significant effects on the historical financial information might have been had the transaction [*or event*] occurred at an earlier date. However, the pro forma condensed financial statements are not necessarily indicative of the results of operations or related effects on financial position that would have been attained had the above-mentioned transaction [*or event*] actually occurred earlier.

[*Additional paragraph(s) may be added to emphasize certain matters relating to the attest engagement or the subject matter.*]

In our opinion, management's assumptions provide a reasonable basis for presenting the significant effects directly attributable to the above-mentioned transaction [*or event*] described in Note 1, the related pro forma adjustments give appropriate effect to those assumptions, and the pro forma column reflects the proper application of those adjustments to the historical financial statement amounts in the pro forma condensed balance sheet as of December 31, 20X1, and the pro forma condensed statement of income for the year then ended.

[*Signature*]

[*Date*]

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[8] This wording is appropriate when one column of pro forma financial information is presented without separate columns of historical financial information and pro forma adjustments.

[9] If either accountant's report includes an explanatory paragraph or is other than unqualified, that fact should be referred to within this report.

[10] If the option in footnote 4 to paragraph .07*a* is followed, the report should be appropriately modified.

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Appendix B

Report on Review of Pro Forma Financial Information

Independent Accountant's Report

We have reviewed the pro forma adjustments reflecting the transaction [*or event*] described in Note 1 and the application of those adjustments to the historical amounts in [*the assembly of*][11] the accompanying pro forma condensed balance sheet of X Company as of March 31, 20X2, and the pro forma condensed statement of income for the three months then ended. These historical condensed financial statements are derived from the historical unaudited financial statements of X Company, which were reviewed by us, and of Y Company, which were reviewed by other accountants,[12, 13] appearing elsewhere herein [*or incorporated by reference*].[14] Such pro forma adjustments are based on management's assumptions as described in Note 2. X Company's management is responsible for the pro forma financial information.

Our review was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. A review is substantially less in scope than an examination, the objective of which is the expression of an opinion on management's assumptions, the pro forma adjustments and the application of those adjustments to historical financial information. Accordingly, we do not express such an opinion.

The objective of this pro forma financial information is to show what the significant effects on the historical financial information might have been had the transaction [*or event*] occurred at an earlier date. However, the pro forma condensed financial statements are not necessarily indicative of the results of operations or related effects on financial position that would have been attained had the above-mentioned transaction [*or event*] actually occurred earlier.

[*Additional paragraph(s) may be added to emphasize certain matters relating to the attest engagement or the subject matter.*]

Based on our review, nothing came to our attention that caused us to believe that management's assumptions do not provide a reasonable basis for presenting the significant effects directly attributable to the above-mentioned transaction [*or event*] described in Note 1, that the related pro forma adjustments do not give

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[11] This wording is appropriate when one column of pro forma financial information is presented without separate columns of historical financial information and pro forma adjustments.

[12] If either accountant's report includes an explanatory paragraph or is modified, that fact should be referred to within this report.

[13] Where one set of historical financial statements is audited and the other set is reviewed, wording similar to the following would be appropriate:

> The historical condensed financial statements are derived from the historical financial statements of X Company, which were audited by us, and of Y Company, which were reviewed by other accountants, appearing elsewhere herein [*or incorporated by reference*].

[14] If the option in footnote 4 to paragraph .07*a* is followed, the report should be appropriately modified.

appropriate effect to those assumptions, or that the pro forma column does not reflect the proper application of those adjustments to the historical financial statement amounts in the pro forma condensed balance sheet as of March 31, 20X2, and the pro forma condensed statement of income for the three months then ended.

[*Signature*]

[*Date*]

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Appendix C

Report on Examination of Pro Forma Financial Information at Year-End With a Review of Pro Forma Financial Information for a Subsequent Interim Date

Independent Accountant's Report

We have examined the pro forma adjustments reflecting the transaction [*or event*] described in Note 1 and the application of those adjustments to the historical amounts in [*the assembly of*][15] the accompanying pro forma financial condensed balance sheet of X Company as of December 31, 20X1, and the pro forma condensed statement of income for the year then ended. The historical condensed financial statements are derived from the historical financial statements of X Company, which were audited by us, and of Y Company, which were audited by other accountants,[16] appearing elsewhere herein [*or incorporated by reference*].[17] Such pro forma adjustments are based upon management's assumptions described in Note 2. X Company's management is responsible for the pro forma financial information. Our responsibility is to express an opinion on the pro forma financial information based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included such procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

In addition, we have reviewed the pro forma adjustments and the application of those adjustments to the historical amounts in [*the assembly of*][15] the accompanying pro forma condensed balance sheet of X Company as of March 31, 20X2, and the pro forma condensed statement of income for the three months then ended. The historical condensed financial statements are derived from the historical financial statements of X Company, which were reviewed by us, and of Y Company, which were reviewed by other accountants,[18] appearing elsewhere herein [*or incorporated by reference*].[19] Such pro forma adjustments are based upon management's assumptions as described in Note 2. Our review

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[15] This wording is appropriate when one column of pro forma financial information is presented without separate columns of historical financial information and pro forma adjustments.

[16] If either accountant's report includes an explanatory paragraph or is other than unqualified, that fact should be referred to within this report.

[17] If the option in footnote 4 to paragraph .07*a* is followed, the report should be appropriately modified.

[18] Where one set of historical financial statements is audited and the other set is reviewed, wording similar to the following would be appropriate:

The historical condensed financial statements are derived from the historical financial statements of X Company, which were audited by us, and of Y Company, which were reviewed by other accountants, appearing elsewhere herein [*or incorporated by reference*].

[19] If the option in footnote 4 to paragraph .07*a* is followed, the report should be appropriately modified.

was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. A review is substantially less in scope than an examination, the objective of which is the expression of an opinion on management's assumptions, the pro forma adjustments, and the application of those adjustments to historical financial information. Accordingly, we do not express such an opinion on the pro forma adjustments or the application of such adjustments to the pro forma condensed balance sheet as of March 31, 20X2, and the pro forma condensed statement of income for the three months then ended.

The objective of this pro forma financial information is to show what the significant effects on the historical financial information might have been had the transactions [*or event*] occurred at an earlier date. However, the pro forma condensed financial statements are not necessarily indicative of the results of operations or related effects on financial position that would have been attained had the above-mentioned transaction [*or event*] actually occurred earlier.

[*Additional paragraph(s) may be added to emphasize certain matters relating to the attest engagements or the subject matter.*]

In our opinion, management's assumptions provide a reasonable basis for presenting the significant effects directly attributable to the above-mentioned transaction [*or event*] described in Note 1, the related pro forma adjustments give appropriate effect to those assumptions, and the pro forma column reflects the proper application of those adjustments to the historical financial statement amounts in the pro forma condensed balance sheet as of December 31, 20X1, and the pro forma condensed statement of income for the year then ended.

Based on our review, nothing came to our attention that caused us to believe that management's assumptions do not provide a reasonable basis for presenting the significant effects directly attributable to the above-mentioned transaction [*or event*] described in Note 1, that the related pro forma adjustments do not give appropriate effect to those assumptions, or that the pro forma column does not reflect the proper application of those adjustments to the historical financial statement amounts in the pro forma condensed balance sheet as of March 31, 20X2, and the pro forma condensed statement of income for the three months then ended.

[*Signature*]

[*Date*]

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Appendix D

Report on Examination of Pro Forma Financial Information Giving Effect to a Business Combination to Be Accounted for as a Pooling of Interests[20]

Independent Accountant's Report

We have examined the pro forma adjustments reflecting the proposed business combination to be accounted for as a pooling of interests described in Note 1 and the application of those adjustments to the historical amounts in the accompanying pro forma condensed balance sheet of X Company as of December 31, 20X1, and the pro forma condensed statements of income for each of three years in the period then ended. These historical condensed financial statements are derived from the historical financial statements of X Company, which were audited by us,[21] and of Y Company, which were audited by other accountants, appearing elsewhere herein [*or incorporated by reference*].[22] Such pro forma adjustments are based upon management's assumptions described in Note 2. X Company's management is responsible for the pro forma financial information. Our responsibility is to express an opinion on the pro forma financial information based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included such procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

The objective of this pro forma financial information is to show what the significant effects on the historical financial information might have been had the transactions [*or event*] occurred at an earlier date.

[*Additional paragraph(s) may be added to emphasize certain matters relating to the attest engagement or the subject matter.*]

In our opinion, the accompanying condensed pro forma financial statements of X Company as of December 31, 20X1, and for each of the three years in the period then ended give appropriate effect to the pro forma adjustments necessary to reflect the proposed business combination on a pooling of interests basis as described in Note 1 and the pro forma column reflects the proper application of those adjustments to the historical financial statements.

[*Signature*]

[*Date*]

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[20] See paragraph .15 for a discussion of the form of the opinion on pro forma financial information in a pooling of interests business combination.

[21] If either accountant's report includes an explanatory paragraph or is other than unqualified, that fact should be referred to within this report.

[22] If the option in footnote 4 to paragraph .07*a* is followed, the report should be appropriately modified.

.22

Appendix E

Other Example Reports

An example of a report qualified because of a scope limitation follows.

Independent Accountant's Report

We have examined the pro forma adjustments reflecting the transaction [*or event*] described in Note 1 and the application of those adjustments to the historical amounts in [*the assembly of*][23] the accompanying pro forma condensed balance sheet of X Company as of December 31, 20X1, and the pro forma condensed statement of income for the year then ended. The historical condensed financial statements are derived from the historical financial statements of X Company, which were audited by us, and of Y Company, which were audited by other accountants,[24] appearing elsewhere herein [*or incorporated by reference*].[25] Such pro forma adjustments are based upon management's assumptions described in Note 2. X Company's management is responsible for the pro forma financial information. Our responsibility is to express an opinion on the pro forma financial information based on our examination.

Except as described below, our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included such procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

We are unable to perform the examination procedures we considered necessary with respect to assumptions relating to the proposed loan described in Adjustment E in Note 2.

[*Same paragraph as third paragraph in examination report in paragraph .18*]

In our opinion, except for the effects of such changes, if any, as might have been determined to be necessary had we been able to satisfy ourselves as to the assumptions relating to the proposed loan, management's assumptions provide a reasonable basis for presenting the significant effects directly attributable to the above-mentioned transaction [*or event*] described in Note 1, the related pro forma adjustments give appropriate effect to those assumptions, and the pro forma column reflects the proper application of those adjustments to the historical financial statement amounts in the pro forma condensed balance sheet as of December 31, 20X1, and the pro forma condensed statement of income for the year then ended.

[*Signature*]

[*Date*]

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[23] This wording is appropriate when one column of pro forma financial information is presented without separate columns of historical financial information and pro forma adjustments.

[24] If either accountant's report includes an explanatory paragraph or is other than unqualified, that fact should be referred to within this report.

[25] If the option in footnote 4 to paragraph .07*a* is followed, the report should be appropriately modified.

An example of a report qualified for reservations about the propriety of assumptions on an acquisition transaction follows:

> [*Same first three paragraphs as examination report in paragraph .18*]
>
> As discussed in Note 2 to the pro forma financial statements, the pro forma adjustments reflect management's assumption that X Division of the acquired company will be sold. The net assets of this division are reflected at their historical carrying amount; generally accepted accounting principles require these net assets to be recorded at estimated net realizable value.
>
> In our opinion, except for inappropriate valuation of the net assets of X Division, management's assumptions described in Note 2 provide a reasonable basis for presenting the significant effects directly attributable to the above-mentioned transaction [*or event*] described in Note 1, the related pro forma adjustments give appropriate effect to those assumptions, and the pro forma column reflects the proper application of those adjustments to the historical financial statement amounts in the pro forma condensed balance sheet as of December 31, 20X1, and the pro forma condensed statement of income for the year then ended.
>
> [*Signature*]
>
> [*Date*]

An example of a disclaimer of opinion because of a scope limitation follows:

<u>Independent Accountant's Report</u>

> We were engaged to examine the pro forma adjustments reflecting the transaction [*or event*] described in Note 1 and the application of those adjustments to the historical amounts in [*the assembly of*][26] the accompanying pro forma financial condensed balance sheet of X Company as of December 31, 20X1, and the pro forma condensed statement of income for the year then ended. The historical condensed financial statements are derived from the historical financial statements of X Company, which were audited by us, and of Y Company, which were audited by other accountants,[27] appearing elsewhere herein [*or incorporated by reference*].[28] Such pro forma adjustments are based upon management's assumptions described in Note 2. X Company's management is responsible for the pro forma financial information.
>
> As discussed in Note 2 to the pro forma financial statements, the pro forma adjustments reflect management's assumptions that the elimination of duplicate facilities would have resulted in a 30 percent reduction in operating costs. Management could not supply us with sufficient evidence to support this assertion.
>
> [*Same paragraph as third paragraph in examination report in paragraph .18*]
>
> Since we were unable to evaluate management's assumptions regarding the reduction in operating costs and other assumptions related thereto, the scope of our work was not sufficient to express and, therefore, we do not express an

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[26] This wording is appropriate when one column of pro forma financial information is presented without separate columns of historical financial information and pro forma adjustments.

[27] If either accountant's report includes an explanatory paragraph or is other than unqualified, that fact should be referred to within this report.

[28] If the option in footnote 4 to paragraph .07*a* is followed, the report should be appropriately modified.

opinion on the pro forma adjustments, management's underlying assumptions regarding those adjustments and the application of those adjustments to the historical financial statement amounts in the pro forma condensed financial statement amounts in the pro forma condensed balance sheet as of December 31, 20X1, and the pro forma condensed statement of income for the year then ended.

[*Signature*]

[*Date*]

AT Section 501

An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements

Source: SSAE No. 15.

See section 9501 for interpretations of this section.

Effective when the subject matter or assertion is as of or for a period ending on or after December 15, 2008. Earlier application is permitted.

Applicability

.01 This section establishes requirements and provides guidance that applies when a practitioner[1] is engaged to perform an examination of the design and operating effectiveness of an entity's internal control over financial reporting (*examination of internal control*)[2] that is integrated with an audit of financial statements (*integrated audit*).[3]

.02 Ordinarily, the auditor will be engaged to examine the effectiveness of the entity's internal control over financial reporting (hereinafter referred to as *internal control*) as of the end of the entity's fiscal year; however, management may select a different date. If the auditor is engaged to examine the effectiveness of an entity's internal control at a date different from the end of the entity's fiscal year, the examination should, nevertheless, be integrated with a financial statement audit (see paragraphs .18–.19).

.03 An auditor may be engaged to examine the effectiveness of an entity's internal control for a period of time. In that circumstance, the guidance in this section should be modified accordingly, and the examination of internal control should be integrated with an audit of financial statements that covers the same period of time.

.04 This section does not provide guidance for the following:

a. Engagements to examine the suitability of design of an entity's internal control. Such engagements may be developed and performed under section 101, *Attest Engagements* [4]

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[1] In this section, the *practitioner* is referred to as the *auditor* because the examination of internal control is integrated with an audit of financial statements, and an examination provides the same level of assurance as an audit.

[2] In this section, the phrase *examination of internal control* means an engagement to report directly on internal control or on management's assertion thereon. The performance guidance in this section applies equally to either reporting alternative.

[3] Certain regulatory bodies require the examination of internal control and the audit of the financial statements to be performed by the same auditor. There are difficulties inherent in integrating the examination of internal control and the audit of the financial statements to meet the requirements of this section when the audit of the financial statements is performed by a different auditor. In such circumstances, the requirements of this section, nevertheless, apply.

[4] Although this section does not apply when an auditor is engaged to examine the suitability of design of an entity's internal control, it may be useful in planning and performing such engagements.

b. Engagements to examine controls over the effectiveness and efficiency of operations. Such engagements may be developed and performed under section 101.

c. Engagements to examine controls over compliance with laws and regulations. See section 601, *Compliance Attestation*.

d. Engagements to report on controls at a service organization. See section 801, *Reporting on Controls at a Service Organization*.

e. Engagements to perform agreed-upon procedures on controls. See section 201, *Agreed-Upon Procedures Engagements*.

[Revised, August 2011, to reflect conforming changes necessary due to the issuance of SSAE No. 16.]

.05 The auditor may be requested to perform certain nonattest services related to the entity's internal control in addition to the examination of internal control. The auditor should determine whether to perform such nonattest services after considering relevant ethical requirements.

.06 An auditor should not accept an engagement to review an entity's internal control or a written assertion thereon.

Definitions and Underlying Concepts

.07 For purposes of this section, the terms listed below are defined as follows:

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

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

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

Financial statements and related disclosures. An entity's financial statements and notes to the financial statements as presented in accordance with the applicable financial reporting framework.[5] References to financial statements and related disclosures do not extend to the preparation

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[5] The *applicable financial reporting framework* is defined in paragraph .14 of AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, as "the financial reporting framework adopted by management and, when appropriate, those charged with governance in the preparation and fair presentation of

(continued)

of other financial information presented outside an entity's basic financial statements and notes.

Internal control over financial reporting.[6] A process effected by those charged with governance, [7] management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with the applicable financial reporting framework and includes those policies and procedures that[8]

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

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

Management's assertion. Management's conclusion about the effectiveness of the entity's internal control that is included in management's report on internal control.

(footnote continued)

the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation." Paragraph .A31 of AU-C section 700, *Forming an Opinion and Reporting on Financial Statements*, provides the following examples of applicable financial reporting frameworks: accounting principles generally accepted in the United States of America (or U.S. generally accepted accounting principles), International Financial Reporting Standards promulgated by the International Accounting Standards Board (IASB), and *International Financial Reporting Standard for Small and Medium-Sized Entities* promulgated by the IASB. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

[6] For insured depository institutions (IDIs) subject to the internal control reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), internal control includes controls over the preparation of the IDI's financial statements and related disclosures in accordance with GAAP and with the instructions to the *Consolidated Financial Statements for Bank Holding Companies*. Internal control also includes controls over the preparation of the IDI's financial statements and related disclosures in accordance with GAAP and controls over the preparation of schedules equivalent to the basic financial statements in accordance with the Federal Financial Institutions Examination Council Instructions for Consolidated Reports of Condition and Income (call report instructions) or with the Office of Thrift Supervision Instructions for Thrift Financial Reports (TFR instructions).

[7] The term *those charged with governance* is defined in paragraph .06 of AU-C section 260, *The Auditor's Communication With Those Charged With Governance*, as "the person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and the obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance may include management personnel; for example, executive members of a governance board or an owner-manager." [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

[8] The auditor's procedures performed as part of the integrated audit are not part of an entity's internal control.

Material weakness. A deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility[9] that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

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

Relevant assertion. A financial statement assertion[10] that has a reasonable possibility of containing a misstatement or misstatements that would cause the financial statements to be materially misstated. The determination of whether an assertion is a relevant assertion is made without regard to the effect of controls.

Significant account or disclosure. An account balance or disclosure that has a reasonable possibility that it could contain a misstatement that, individually or when aggregated with others, has a material effect on the financial statements, considering the risks of both overstatement and understatement. The determination of whether an account balance or disclosure is a significant account or disclosure is made without regard to the effect of controls.

Significant account or disclosure. An account balance or disclosure that has a reasonable possibility that it could contain a misstatement that, individually or when aggregated with others, has a material effect on the financial statements, considering the risks of both overstatement and understatement. The determination of whether an account balance or disclosure is a significant account or disclosure is made without regard to the effect of controls.

Significant deficiency. 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.

.08 Effective internal control provides reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes. If one or more material weaknesses exist, the entity's internal control cannot be considered effective.

.09 The auditor's objective in an examination of internal control is to form an opinion on the effectiveness of the entity's internal control. Because an entity's internal control cannot be considered effective if one or more material weaknesses exist, to form a basis for expressing an opinion, the auditor should plan and perform the examination to obtain sufficient appropriate evidence to obtain reasonable assurance[11] about whether material weaknesses exist as of

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[9] A reasonable possibility exists when the chance of the future event or events occurring is more than remote. [Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC. Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

[10] The financial statement assertions are described in paragraph .A114 of AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. The auditor may use the financial statement assertions as they are described in AU-C section 315 or may express them differently, provided that all aspects described in AU-C section 315 have been covered. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

[11] The high, but not absolute, level of assurance that is intended to be obtained by the auditor is expressed in the auditor's report as obtaining reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects as of the date specified in management's assertion. See paragraph .54 of section 101, *Attest Engagements*, and AU-C section 200. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.].

the date specified in management's assertion. A material weakness in internal control may exist even when financial statements are not materially misstated. The auditor is not required to search for deficiencies that, individually or in combination, are less severe than a material weakness.

.10 An auditor engaged to perform an examination of internal control should comply with the general, fieldwork, and reporting standards in section 101, and the specific performance and reporting requirements set forth in this section. In this section, the subject matter is the effectiveness of internal control, and the responsible party usually is management of the entity. Accordingly, the term *management* is used in this section to refer to the responsible party.

.11 The auditor should use the same suitable and available control criteria[12] to perform his or her examination of internal control as management uses for its evaluation of the effectiveness of the entity's internal control.

.12 An auditor may perform an examination of internal control only if the following conditions are met:

a. Management accepts responsibility for the effectiveness of the entity's internal control.

b. Management evaluates the effectiveness of the entity's internal control using suitable and available criteria.

c. Management supports its assertion about the effectiveness of the entity's internal control with sufficient appropriate evidence (see discussion beginning at paragraph .14).

d. Management provides its assertion about the effectiveness of the entity's internal control in a report that accompanies the auditor's report (see paragraph .95).

.13 Management's refusal to furnish a written assertion should cause the auditor to withdraw from the engagement. However, if law or regulation does not allow the auditor to withdraw from the engagement and management refuses to furnish a written assertion, the auditor should disclaim an opinion on internal control.[13]

Evidence Supporting Management's Assertion

.14 Management is responsible for identifying and documenting the controls and the control objectives that they were designed to achieve. Such documentation serves as a basis for management's assertion. Documentation of the design of controls, including changes to those controls, is evidence that controls upon which management's assertion is based are

- identified.

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[12] According to paragraph .23 of section 101 "[t]he third general attestation standard is—*The auditor must have reason to believe that the subject matter is capable of evaluation against criteria that are suitable and available to users.*" The Committee of Sponsoring Organizations of the Treadway Commission's (COSO) report *Internal Control—Integrated Framework* provides suitable and available criteria against which management may evaluate and report on the effectiveness of the entity's internal control. *Internal Control—Integrated Framework* describes an entity's internal control as consisting of five components: control environment, risk assessment, information and communication, control activities, and monitoring. See AU-C section 315 for a discussion of these components. If management selects another framework, see paragraphs .23–.34 of section 101 for guidance on evaluating the suitability and availability of criteria. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

[13] See paragraphs .117–.121 when disclaiming an opinion, including the requirement for the auditor's report to include a description of any material weaknesses identified.

- capable of being communicated to those responsible for their performance.
- capable of being monitored and evaluated by the entity.

.15 Management's documentation may take various forms, for example, entity policy manuals, accounting manuals, narrative memoranda, flowcharts, decision tables, procedural write-ups, or completed questionnaires. No one, particular form of documentation is prescribed, and the extent of documentation may vary depending upon the size and complexity of the entity and the entity's monitoring activities.

.16 Management's monitoring activities also may provide evidence of the design and operating effectiveness of internal control in support of management's assertion. Monitoring of controls is a process to assess the effectiveness of internal control performance over time. It involves assessing the effectiveness of controls on a timely basis, identifying and reporting deficiencies to appropriate individuals within the organization, and taking necessary corrective actions. Management accomplishes monitoring of controls through ongoing activities, separate evaluations, or a combination of the two.

.17 Ongoing monitoring activities are often built into the normal recurring activities of an entity and include regular management and supervisory activities. The greater the degree and effectiveness of ongoing monitoring, the less need for separate evaluations. Usually, some combination of ongoing monitoring and separate evaluations will ensure that internal control maintains its effectiveness over time.

Integrating the Examination With the Financial Statement Audit

.18 The examination of internal control should be integrated with an audit of financial statements. Although the objectives of the engagements are not the same, the auditor should plan and perform the integrated audit to achieve the objectives of both engagements simultaneously. The auditor should design tests of controls

- to obtain sufficient appropriate evidence to support the auditor's opinion on internal control as of the period-end; and
- to obtain sufficient appropriate evidence to support the auditor's control risk assessments for purposes of the audit of financial statements.

.19 The date specified in management's assertion (the as-of date of the examination) should correspond to the balance sheet date (or period ending date) of the period covered by the financial statements (see paragraph .02).

.20 Obtaining sufficient appropriate evidence to support the operating effectiveness of controls for purposes of the financial statement audit ordinarily allows the auditor to modify the substantive procedures that otherwise would have been necessary to opine on the financial statements. (Integration is described further beginning at paragraph .159.)

.21 In some circumstances, particularly in some audits of smaller, less complex entities, the auditor might choose not to test the operating effectiveness of controls for purposes of the audit of the financial statements. In such circumstances, the auditor's tests of the operating effectiveness of controls would be performed principally for the purpose of supporting his or her opinion on whether the entity's internal control is effective as of period-end. The auditor should consider the results of the financial statement auditing procedures in determining his or her risk assessments and the testing necessary to conclude on the operating effectiveness of a control.

Planning the Examination

.22 The auditor should plan the examination of internal control. Evaluating whether the following matters are important to the entity's financial statements and internal control and, if so, how they may affect the auditor's procedures, may assist the auditor in planning the examination:

- Knowledge of the entity's internal control obtained during other engagements performed by the auditor or, if applicable, during a review of a predecessor auditor's working papers
- Matters affecting the industry in which the entity operates, such as financial reporting practices, economic conditions, laws and regulations, and technological changes
- Matters relating to the entity's business, including its organization, operating characteristics, and capital structure
- The extent of recent changes, if any, in the entity, its operations, or its internal control
- The auditor's preliminary judgments about materiality, risk, and other factors relating to the determination of material weaknesses
- Deficiencies previously communicated to those charged with governance or management
- Legal or regulatory matters of which the entity is aware
- The type and extent of available evidence related to the effectiveness of the entity's internal control
- Preliminary judgments about the effectiveness of internal control
- Public information about the entity relevant to the evaluation of the likelihood of material financial statement misstatements and the effectiveness of the entity's internal control
- Knowledge about risks related to the entity evaluated as part of the auditor's client acceptance and retention evaluation
- The relative complexity of the entity's operations

Role of Risk Assessment

.23 Risk assessment underlies the entire examination process described by this section, including the determination of significant accounts and disclosures and relevant assertions, the selection of controls to test, and the determination of the evidence necessary to conclude on the effectiveness of a given control. When performing an examination of internal control that is integrated with an audit of financial statements, the same risk assessment process supports both engagements.[14]

.24 The auditor should focus more attention on the areas of highest risk. A direct relationship exists between the degree of risk that a material weakness could exist in a particular area of the entity's internal control and the amount

[14] The risk assessment procedures performed in connection with a financial statement audit are described in AU-C section 315. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

of attention that would be devoted to that area. In addition, an entity's internal control is less likely to prevent, or detect and correct a misstatement caused by fraud than a misstatement caused by error. It is not necessary to test controls that, even if deficient, would not present a reasonable possibility of material misstatement to the financial statements.

Scaling the Examination

.25 The size and complexity of the entity, its business processes, and business units may affect the way in which the entity achieves many of its control objectives. Many smaller entities have less complex operations. Additionally, some larger, complex entities may have less complex units or processes. Factors that might indicate less complex operations include fewer business lines; less complex business processes and financial reporting systems; more centralized accounting functions; extensive involvement by senior management in the day-to-day activities of the business; and fewer levels of management, each with a wide span of control. Accordingly, a smaller, less complex entity, or even a larger, less complex entity might achieve its control objectives differently from a more complex entity.

.26 The size and complexity of the organization, its business processes, and business units also may affect the auditor's risk assessment and the determination of the necessary procedures and the controls necessary to address those risks. Scaling is most effective as a natural extension of the risk-based approach and applicable to examinations of all entities.

Addressing the Risk of Fraud

.27 When planning and performing the examination of internal control, the auditor should incorporate the results of the fraud risk assessment performed in the financial statement audit. As part of identifying and testing entity-level controls, as discussed beginning at paragraph .37, and selecting other controls to test, as discussed beginning at paragraph .54, the auditor should evaluate whether the entity's controls sufficiently address identified risks of material misstatement due to fraud[15] and the risk of management override of other controls. Controls that might address these risks include

- controls over significant, unusual transactions, particularly those that result in late or unusual journal entries;
- controls over journal entries and adjustments made in the period-end financial reporting process;
- controls over related party transactions;
- controls related to significant management estimates; and
- controls that mitigate incentives for, and pressures on, management to falsify or inappropriately manage financial results.

.28 If the auditor identifies deficiencies in controls designed to prevent, or detect and correct misstatements caused by fraud during the examination of internal control, he or she should take into account those deficiencies when developing his or her response to risks of material misstatement during the

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[15] See paragraphs .25–.27 of AU-C section 240, *Consideration of Fraud in a Financial Statement Audit*, regarding the auditor's identification and assessment of the risks of material misstatement due to fraud. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

financial statement audit, as provided in paragraphs .28–.33 of AU-C section 240, *Consideration of Fraud in a Financial Statement Audit*. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Using the Work of Others

.29 The auditor should evaluate the extent to which he or she will use the work of others to reduce the work the auditor might otherwise perform himself or herself.

.30 AU-C section 610, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*, applies in an integrated audit. For purposes of the examination of internal control, however, the auditor may use the work performed by, or receive direct assistance from, internal auditors, entity personnel (in addition to internal auditors), and third parties working under the direction of management or those charged with governance that provide evidence about the effectiveness of internal control. In an integrated audit, the auditor also may use this work to obtain evidence supporting the assessment of control risk for purposes of the financial statement audit. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.31 The auditor should obtain an understanding of the work of others sufficient to identify those activities related to the effectiveness of internal control that are relevant to planning the examination of internal control. The extent of the procedures necessary to obtain this understanding will vary, depending on the nature of those activities.

.32 The auditor should assess the competence and objectivity of the persons whose work the auditor plans to use to determine the extent to which the auditor may use their work. The higher the degree of competence and objectivity, the greater use the auditor may make of the work. The auditor should apply paragraphs .09–.11 of AU-C section 610 to assess the competence and objectivity of internal auditors. The auditor should apply the principles underlying those paragraphs to assess the competence and objectivity of persons other than internal auditors whose work the auditor plans to use. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.33 For purposes of using the work of others, competence means the attainment and maintenance of a level of understanding, knowledge, and skills that enables that person to perform ably the tasks assigned to them, and objectivity means the ability to perform those tasks impartially and with intellectual honesty. To assess competence, the auditor should evaluate factors about the person's qualifications and ability to perform the work that the auditor plans to use. To assess objectivity, the auditor should evaluate whether factors are present that either inhibit or promote a person's ability to perform with the necessary degree of objectivity the work that the auditor plans to use. The effect of the work of others on the auditor's work also depends on the relationship between the risk associated with a control and the competence and objectivity of those who performed the work. As the risk associated with a control decreases, the necessary level of competence and objectivity decreases as well. In higher risk areas (for example, controls that address specific fraud risks), use of the work of others would be limited, if it could be used at all.

.34 The extent to which the auditor may use the work of others also depends, in part, on the risk associated with the control being tested (see paragraph .62). As the risk associated with a control increases, the need for the auditor to perform his or her own work on the control increases.

Materiality

.35 In planning and performing the examination of internal control, the auditor should use the same materiality used in planning and performing the audit of the entity's financial statements.[16]

Using a Top-Down Approach

.36 The auditor should use a top-down approach[17] to the examination of internal control to select the controls to test. A top-down approach involves

- beginning at the financial statement level;
- using the auditor's understanding of the overall risks to internal control;
- focusing on entity-level controls;
- working down to significant accounts and disclosures and their relevant assertions;
- directing attention to accounts, disclosures, and assertions that present a reasonable possibility of material misstatement to the financial statements and related disclosures;
- verifying the auditor's understanding of the risks in the entity's processes; and
- selecting controls for testing that sufficiently address the assessed risk of material misstatement to each relevant assertion.

Identifying Entity-Level Controls

.37 The auditor should test those entity-level controls that are important to his or her conclusion about whether the entity has effective internal control. The auditor's evaluation of entity-level controls can result in increasing or decreasing the testing that he or she otherwise would have performed on other controls.

.38 Entity-level controls include

- controls related to the control environment;
- controls over management override;[18]
- the entity's risk assessment process;
- centralized processing and controls, including shared service environments;

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[16] See AU-C section 320, *Audit Risk and Materiality in Planning and Performing an Audit*, which provides additional explanation of materiality. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

[17] The top-down approach describes the auditor's sequential thought process in identifying risks and the controls to test, not necessarily the order in which the auditor will perform the examination procedures.

[18] Controls over management override are important to effective internal control for all entities and may be particularly important at smaller, less complex entities because of the increased involvement of senior management in performing controls and in the period-end financial reporting process. For smaller, less complex entities, the controls that address the risk of management override might be different from those at a larger entity. For example, a smaller, less complex entity might rely on more detailed oversight by those charged with governance that focuses on the risk of management override.

- controls to monitor results of operations;
- controls to monitor other controls, including activities of the internal audit function, those charged with governance, and self-assessment programs;
- controls over the period-end financial reporting process; and
- programs and controls that address significant business control and risk management practices.

.39 Entity-level controls vary in nature and precision:

- Some entity-level controls, such as certain control environment controls, have an important but indirect effect on the likelihood that a misstatement will be prevented, or detected and corrected on a timely basis. These controls might affect the other controls that the auditor selects for testing and the nature, timing, and extent of procedures the auditor performs on other controls.
- Some entity-level controls monitor the effectiveness of other controls. Such controls might be designed to identify possible breakdowns in lower level controls, but not at a level of precision that would, by themselves, sufficiently address the assessed risk that material misstatements to a relevant assertion will be prevented, or detected and corrected on a timely basis. These controls, when operating effectively, might allow the auditor to reduce the testing of other controls.
- Some entity-level controls might be designed to operate at a level of precision that would adequately prevent, or detect and correct on a timely basis misstatements to one or more relevant assertions. If an entity-level control sufficiently addresses the assessed risk of material misstatement, the auditor need not test additional controls relating to that risk.

Control Environment

.40 Because of its importance to effective internal control, the auditor should evaluate the control environment at the entity. When evaluating the control environment, the auditor should apply paragraph .15 of AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. As part of evaluating the control environment, the auditor should assess

- whether management's philosophy and operating style promote effective internal control;
- whether sound integrity and ethical values, particularly of top management, are developed and understood; and
- whether those charged with governance understand and exercise oversight responsibility over financial reporting and internal control.

[Revised, December 2012 and July 2013, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Period-End Financial Reporting Process

.41 Because of its importance to financial reporting and to the integrated audit, the auditor should evaluate the period-end financial reporting process.[19] The period-end financial reporting process includes the following:

- Procedures used to enter transaction totals into the general ledger

[19] Because the annual period-end financial reporting process normally occurs after the as-of date of management's assertion, those controls usually cannot be tested until after the as-of date.

- Procedures related to the selection and application of accounting policies
- Procedures used to initiate, authorize, record, and process journal entries in the general ledger
- Procedures used to record recurring and nonrecurring adjustments to the financial statements
- Procedures for preparing financial statements and related disclosures

.42 As part of evaluating the period-end financial reporting process, the auditor should assess

- the inputs, procedures performed, and outputs of the processes the entity uses to produce its financial statements;
- the extent of IT involvement in the period-end financial reporting process;
- who participates from management;
- the locations involved in the period-end financial reporting process;
- the types of adjusting and consolidating entries; and
- the nature and extent of the oversight of the process by management and those charged with governance.

Identifying Significant Accounts and Disclosures and Their Relevant Assertions

.43 The auditor should identify significant accounts and disclosures and their relevant assertions. To identify significant accounts and disclosures and their relevant assertions, the auditor should evaluate the qualitative and quantitative risk factors related to the financial statement line items and disclosures. Risk factors relevant to the identification of significant accounts and disclosures and their relevant assertions include

- size and composition of the account;
- susceptibility to misstatement due to errors or fraud;
- volume of activity, complexity, and homogeneity of the individual transactions processed through the account or reflected in the disclosure;
- nature of the account, class of transactions, or disclosure;
- accounting and reporting complexities associated with the account, class of transactions, or disclosure;
- exposure to losses in the account;
- possibility of significant contingent liabilities arising from the activities reflected in the account or disclosure;
- existence of related party transactions in the account; and
- changes from the prior period in the account, class of transactions, or disclosure characteristics.

.44 As part of identifying significant accounts and disclosures and their relevant assertions, the auditor also should determine the likely sources of potential misstatements that would cause the financial statements to be materially misstated. The auditor might determine the likely sources of potential misstatements by asking himself or herself "what could go wrong?" within a given significant account or disclosure.

.45 The risk factors that the auditor should evaluate in the identification of significant accounts and disclosures and their relevant assertions are the same in the examination of internal control as in the audit of the financial statements; accordingly, significant accounts and disclosures and their relevant assertions are the same in an integrated audit.[20]

.46 The components of a potential significant account or disclosure might be subject to significantly different risks. If so, different controls might be necessary to adequately address those risks.

.47 When an entity has multiple locations or business units, the auditor should identify significant accounts and disclosures and their relevant assertions based on the consolidated financial statements.

Understanding Likely Sources of Misstatement

.48 To further understand the likely sources of potential misstatements, and as a part of selecting the controls to test, the auditor should achieve the following objectives:

- Understand the flow of transactions related to the relevant assertions, including how these transactions are initiated, authorized, processed, and recorded
- Identify the points within the entity's processes at which a misstatement, including a misstatement due to fraud, could arise that, individually or in combination with other misstatements, would be material (for example, points at which information is initiated, transferred, or otherwise modified)
- Identify the controls that management has implemented to address these potential misstatements
- Identify the controls that management has implemented over the prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could result in a material misstatement of the financial statements

.49 Because of the degree of judgment required, the auditor should either perform the procedures that achieve the objectives in paragraph .48 himself or herself or supervise the work of others who provide direct assistance to the auditor, as described in AU-C section 610. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.50 The auditor also should understand how IT affects the entity's flow of transactions and apply paragraph .22 of AU-C section 315. Paragraphs .A54–.A60 and .A98–.A101 of AU-C section 315 discuss the effect of IT on internal control and the risks to assess. [Revised, December 2012 and July 2013, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.51 The identification of risks and controls within IT is not a separate evaluation. Instead, it is an integral part of the top-down approach used to identify likely sources of misstatement and the controls to test, as well as to assess risk and allocate audit effort.

Performing Walkthroughs

.52 Performing walkthroughs will frequently be the most effective way of achieving the objectives in paragraph .48. A walkthrough involves following

[20] The risk assessment procedures performed in connection with a financial statement audit are described in AU-C section 315. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS No. 122–126.]

a transaction from origination through the entity's processes, including information systems, until it is reflected in the entity's financial records, using the same documents and IT that entity personnel use. Walkthrough procedures may include a combination of inquiry, observation, inspection of relevant documentation, recalculation, and control reperformance.

.53 A walkthrough includes questioning the entity's personnel about their understanding of what is required by the entity's prescribed procedures and controls at the points at which important processing procedures occur. These probing questions, combined with the other walkthrough procedures, allow the auditor to gain a sufficient understanding of the process and to be able to identify important points at which a necessary control is missing or not designed effectively. Additionally, probing questions that go beyond a narrow focus on the single transaction used as the basis for the walkthrough may provide an understanding of the different types of significant transactions handled by the process.

Selecting Controls to Test

.54 The auditor should test those controls that are important to the auditor's conclusion about whether the entity's controls sufficiently address the assessed risk of material misstatement to each relevant assertion.

.55 There might be more than one control that addresses the assessed risk of material misstatement to a particular relevant assertion; conversely, one control might address the assessed risk of material misstatement to more than one relevant assertion. It may not be necessary to test all controls related to a relevant assertion nor necessary to test redundant controls, unless redundancy is, itself, a control objective.

.56 The decision concerning whether a control would be selected for testing depends on which controls, individually or in combination, sufficiently address the assessed risk of material misstatement to a given relevant assertion rather than on how the control is labeled (for example, entity-level control, transaction-level control, control activity, monitoring control, preventive control, or detective control).

Testing Controls

Evaluating Design Effectiveness

.57 The auditor should evaluate the design effectiveness of controls by determining whether the entity's controls, if they are applied as prescribed by persons possessing the necessary authority and competence to perform the control effectively, satisfy the entity's control objectives, and can effectively prevent, or detect and correct misstatements caused by errors or fraud that could result in material misstatements in the financial statements.

.58 A smaller, less complex entity might achieve its control objectives in a different manner from a larger, more complex organization. For example, a smaller, less complex entity might have fewer employees in the accounting function, limiting opportunities to segregate duties and leading the entity to implement alternative controls to achieve its control objectives. In such circumstances, the auditor should evaluate whether those alternative controls are effective.

.59 Procedures performed to evaluate design effectiveness may include a mix of inquiry of appropriate personnel, observation of the entity's operations, and inspection of relevant documentation. Walkthroughs that include these procedures ordinarily are sufficient to evaluate design effectiveness.

Testing Operating Effectiveness

.60 The auditor should test the operating effectiveness of a control by determining whether the control is operating as designed and whether the person performing the control possesses the necessary authority and competence to perform the control effectively.[21]

.61 Procedures performed to test operating effectiveness may include a mix of inquiry of appropriate personnel, observation of the entity's operations, inspection of relevant documentation, recalculation, and reperformance of the control.

Relationship of Risk to the Evidence to Be Obtained

.62 For each control selected for testing, the evidence necessary to persuade the auditor that the control is effective depends upon the risk associated with the control. The risk associated with a control consists of the risk that the control might not be effective and, if not effective, the risk that a material weakness exists. As the risk associated with the control being tested increases, the evidence that the auditor should obtain also increases.

.63 Although the auditor should obtain evidence about the effectiveness of controls for each relevant assertion, he or she is not responsible for obtaining sufficient appropriate evidence to support an opinion about the effectiveness of each individual control. Rather, the auditor's objective is to express an opinion on the entity's internal control overall. This allows the auditor to vary the evidence obtained regarding the effectiveness of individual controls selected for testing based on the risk associated with the individual control.

.64 Factors that affect the risk associated with a control may include

- the nature and materiality of misstatements that the control is intended to prevent, or detect and correct;
- the inherent risk associated with the related account(s) and assertion(s);
- whether there have been changes in the volume or nature of transactions that might adversely affect control design or operating effectiveness;
- whether the account has a history of errors;
- the effectiveness of entity-level controls, especially controls that monitor other controls;
- the nature of the control and the frequency with which it operates;
- the degree to which the control relies on the effectiveness of other controls (for example, the control environment or IT general controls);
- the competence of the personnel who perform the control or monitor its performance and whether there have been changes in key personnel who perform the control or monitor its performance;

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[21] In some situations, particularly in smaller, less complex entities, an entity might use a third party to provide assistance with certain financial reporting functions. When assessing the competence of personnel responsible for an entity's financial reporting and associated controls, the auditor may take into account the combined competence of entity personnel and other parties that assist with functions related to financial reporting.

- whether the control relies on performance by an individual or is automated (that is, an automated control would generally be expected to be lower risk if relevant IT general controls are effective);[22] and
- the complexity of the control and the significance of the judgments that would be made in connection with its operation.[23]

.65 When the auditor identifies control deviations, he or she should determine the effect of the deviations on his or her assessment of the risk associated with the control being tested and the evidence to be obtained, as well as on the operating effectiveness of the control.

.66 Because effective internal control cannot and does not provide absolute assurance of achieving the entity's control objectives, an individual control does not necessarily have to operate without any deviation to be considered effective.

.67 The evidence provided by the auditor's tests of the effectiveness of controls depends upon the mix of the nature, timing, and extent of the auditor's procedures. Further, for an individual control, different combinations of the nature, timing, and extent of testing may provide sufficient appropriate evidence in relation to the risk associated with the control.

.68 Walkthroughs may include a combination of inquiry of appropriate personnel, observation of the entity's operations, inspection of relevant documentation, recalculation, and reperformance of the control and might provide sufficient appropriate evidence of operating effectiveness, depending on the risk associated with the control being tested, the specific procedures performed as part of the walkthrough, and the results of those procedures.

Nature of Tests of Controls

.69 Some types of tests, by their nature, produce greater evidence of the effectiveness of controls than other tests. The following tests that the auditor might perform are presented in order of the evidence that they ordinarily would produce, from least to most: inquiry, observation, inspection of relevant documentation, recalculation, and reperformance of a control. Inquiry alone, however, does not provide sufficient appropriate evidence to support a conclusion about the effectiveness of a control.

.70 The nature of the tests of effectiveness that will provide sufficient appropriate evidence depends, to a large degree, on the nature of the control to be tested, including whether the operation of the control results in documentary evidence of its operation. Documentary evidence of the operation of some controls, such as management's philosophy and operating style, might not exist.

.71 A smaller, less complex entity or unit might have less formal documentation regarding the operation of its controls. In those situations, testing controls through inquiry combined with other procedures, such as observation of activities, inspection of less formal documentation, recalculation, or reperformance of certain controls, might provide sufficient appropriate evidence about whether the control is effective.

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[22] A smaller, less complex entity or business unit with simple business processes and centralized accounting operations might have relatively simple information systems that make greater use of off-the-shelf packaged software without modification. In the areas in which off-the-shelf software is used, the auditor's testing of IT controls might focus on the application controls built into the prepackaged software that management relies on to achieve its control objectives and the IT general controls that are important to the effective operation of those application controls.

[23] Generally, a conclusion that a control is not operating effectively can be supported by less evidence than is necessary to support a conclusion that a control is operating effectively.

Timing and Extent of Tests of Controls

.72 Testing controls over a longer period of time provides more evidence of the effectiveness of controls than testing over a shorter period of time. Further, testing performed closer to the date of management's assertion provides more evidence than testing performed earlier in the year. The auditor should balance performing the tests of controls closer to the as-of date with the need to test controls over a sufficient period of time to obtain sufficient appropriate evidence of operating effectiveness.

.73 Prior to the date specified in management's assertion, management might implement changes to the entity's controls to make them more effective or efficient or to address deficiencies. If the auditor determines that the new controls achieve the related objectives of the control criteria and have been in effect for a sufficient period to permit the auditor to assess their design and operating effectiveness by performing tests of controls, he or she will not need to test the design and operating effectiveness of the superseded controls for purposes of expressing an opinion on internal control. If the operating effectiveness of the superseded controls is important to the auditor's control risk assessment in the financial statement audit, the auditor should test the design and operating effectiveness of those superseded controls, as appropriate. (Integration is discussed beginning at paragraph .159.)

.74 The more extensively a control is tested, the greater the evidence obtained from that test.

Rollforward Procedures

.75 When the auditor reports on the effectiveness of controls as of a specific date and obtains evidence about the operating effectiveness of controls at an interim date, he or she should determine what additional evidence concerning the operation of the controls for the remaining period is necessary.

.76 The additional evidence that is necessary to update the results of testing from an interim date to the entity's period-end depends on the following factors:[24]

- The specific control tested prior to the as-of date, including the risks associated with the control, the nature of the control, and the results of those tests
- The sufficiency of the evidence of operating effectiveness obtained at an interim date
- The length of the remaining period
- The possibility that there have been any significant changes in internal control subsequent to the interim date

Special Considerations for Subsequent Years' Examinations

.77 In subsequent years' examinations, the auditor should incorporate knowledge obtained during past examinations he or she performed of the entity's internal control into the decision making process for determining the nature, timing, and extent of testing necessary. This decision making process is described in paragraphs .62–.76.

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[24] In some circumstances, such as when evaluation of these factors indicates a low risk that the controls are no longer effective during the rollforward period, inquiry alone might be sufficient as a rollforward procedure.

.78 Factors that affect the risk associated with a control in subsequent years' examinations include those in paragraph .64 and the following:

- The nature, timing, and extent of procedures performed in previous examinations
- The results of the previous years' testing of the control
- Whether there have been changes in the control or the process in which it operates since the previous examination

.79 After taking into account the risk factors identified in paragraphs .64 and .78, the additional information available in subsequent years' examinations might permit the auditor to assess the risk as lower than in the initial year. This, in turn, might permit the auditor to reduce testing in subsequent years.

.80 The auditor also may use a benchmarking strategy for automated application controls in subsequent years' examinations. Benchmarking is described further beginning at paragraph .153.

.81 In addition, the auditor should vary the nature, timing, and extent of testing of controls from period to period to introduce unpredictability into the testing and respond to changes in circumstances. For this reason, the auditor might test controls at a different interim period, increase or reduce the number and types of tests performed, or change the combination of procedures used.

Evaluating Identified Deficiencies

.82 The auditor should evaluate the severity of each deficiency to determine whether the deficiency, individually or in combination, is a material weakness as of the date of management's assertion.

.83 The severity of a deficiency depends on

- the magnitude of the potential misstatement resulting from the deficiency or deficiencies; and
- whether there is a reasonable possibility that the entity's controls will fail to prevent, or detect and correct a misstatement of an account balance or disclosure.

The severity of a deficiency does not depend on whether a misstatement actually occurred.

.84 Factors that affect the magnitude of the misstatement that might result from a deficiency or deficiencies include, but are not limited to, the following:

- The financial statement amounts or total of transactions exposed to the deficiency
- The volume of activity (in the current period or expected in future periods) in the account or class of transactions exposed to the deficiency

.85 In evaluating the magnitude of the potential misstatement, the maximum amount by which an account balance or total of transactions can be overstated is generally the recorded amount, whereas understatements could be larger.

.86 Risk factors affect whether there is a reasonable possibility that a deficiency, or a combination of deficiencies, will result in a misstatement of an account balance or disclosure. The factors include, but are not limited to, the following:

- The nature of the financial statement accounts, classes of transactions, disclosures, and assertions involved

- The susceptibility of the related asset or liability to loss or fraud
- The subjectivity, complexity, or extent of judgment required to determine the amount involved
- The interaction or relationship of the control with other controls
- The interaction among the deficiencies
- The possible future consequences of the deficiency

.87 The evaluation of whether a deficiency presents a reasonable possibility of misstatement may be made without quantifying the probability of occurrence as a specific percentage or range. Also, in many cases, the probability of a small misstatement will be greater than the probability of a large misstatement.

.88 Multiple deficiencies that affect the same significant account or disclosure, relevant assertion, or component of internal control increase the likelihood of material misstatement and may, in combination, constitute a material weakness, even though such deficiencies individually may be less severe. Therefore, the auditor should determine whether deficiencies that affect the same significant account or disclosure, relevant assertion, or component of internal control collectively result in a material weakness.

.89 Multiple deficiencies that affect the same significant account or disclosure, relevant assertion, or component of internal control also may collectively result in a significant deficiency.

.90 A compensating control can limit the severity of a deficiency and prevent it from being a material weakness. Although compensating controls can mitigate the effects of a deficiency, they do not eliminate the deficiency. The auditor should evaluate the effect of compensating controls when determining whether a deficiency or combination of deficiencies is a material weakness. To have a mitigating effect, the compensating control should operate at a level of precision that would prevent, or detect and correct a material misstatement. The auditor should test the operating effectiveness of compensating controls.

Indicators of Material Weaknesses

.91 Indicators of material weaknesses in internal control include

- identification of fraud, whether or not material, on the part of senior management;
- restatement of previously issued financial statements to reflect the correction of a material misstatement due to error or fraud;
- identification by the auditor of a material misstatement of financial statements under audit in circumstances that indicate that the misstatement would not have been detected and corrected by the entity's internal control; and
- ineffective oversight of the entity's financial reporting and internal control by those charged with governance.

.92 If the auditor determines that a deficiency, or a combination of deficiencies, is not a material weakness, he or she should consider whether prudent officials, having knowledge of the same facts and circumstances, would likely reach the same conclusion.

Concluding Procedures

Forming an Opinion

.93 The auditor should form an opinion on the effectiveness of internal control by evaluating evidence obtained from all sources, including the auditor's testing of controls, misstatements detected during the financial statement audit, and any identified deficiencies.

.94 As part of this evaluation, the auditor should review reports issued during the year by internal audit (or similar functions) that address controls related to internal control and evaluate deficiencies identified in those reports.

.95 After forming an opinion on the effectiveness of the entity's internal control, the auditor should evaluate management's report to determine whether it appropriately contains the following:

- A statement regarding management's responsibility for internal control
- A description of the subject matter of the examination (for example, controls over the preparation of the entity's financial statements in accordance with generally accepted accounting principles [GAAP])
- An identification of the criteria against which internal control is measured (for example, criteria established in the Committee of Sponsoring Organizations of the Treadway Commission's *Internal Control—Integrated Framework*)
- Management's assertion about the effectiveness of internal control
- A description of the material weaknesses, if any
- The date as of which management's assertion is made

.96 If the auditor determines that any required element of management's report is incomplete or improperly presented, the auditor should request management to revise its report. If management does not revise its report, the auditor should apply paragraph .116. If management refuses to furnish a report, the auditor should apply paragraph .13.

Obtaining Written Representations

.97 In an examination of internal control, the auditor should obtain written representations from management

a. acknowledging management's responsibility for establishing and maintaining effective internal control;

b. stating that management has performed an evaluation of the effectiveness of the entity's internal control and specifying the control criteria;

c. stating that management did not use the auditor's procedures performed during the integrated audit as part of the basis for management's assertion;

d. stating management's assertion about the effectiveness of the entity's internal control based on the control criteria as of a specified date;

e. stating that management has disclosed to the auditor all deficiencies in the design or operation of internal control, including separately disclosing to the auditor all such deficiencies that it believes to be significant deficiencies or material weaknesses in internal control;

f. describing any fraud resulting in a material misstatement to the entity's financial statements and any other fraud that does not result in a material misstatement to the entity's financial statements, but involves senior management or management or other employees who have a significant role in the entity's internal control;

g. stating whether the significant deficiencies and material weaknesses identified and communicated to management and those charged with governance during previous engagements pursuant to paragraph .100 have been resolved and specifically identifying any that have not; and

h. stating whether there were, subsequent to the date being reported on, any changes in internal control or other factors that might significantly affect internal control, including any corrective actions taken by management with regard to significant deficiencies and material weaknesses.

.98 The failure to obtain written representations from management, including management's refusal to furnish them, constitutes a limitation on the scope of the examination.[25] The auditor should evaluate the effects of management's refusal on his or her ability to rely on other representations, such as those obtained in the audit of the entity's financial statements.

.99 The auditor should apply AU-C section 580, *Written Representations*, as it relates to matters such as who should sign the letter, the period to be covered by the letter, and when to obtain an updated letter. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Communicating Certain Matters

.100 Deficiencies identified during the integrated audit that, upon evaluation, are considered significant deficiencies or material weaknesses should be communicated, in writing, to management and those charged with governance as a part of each integrated audit, including significant deficiencies and material weaknesses that were previously communicated to management and those charged with governance and have not yet been remediated. Significant deficiencies and material weaknesses that previously were communicated and have not yet been remediated may be communicated, in writing, by referring to the previously issued written communication and the date of that communication.

.101 If the auditor concludes that the oversight of the entity's financial reporting and internal control by the audit committee (or similar subgroups with different names) is ineffective, the auditor should communicate that conclusion, in writing, to the board of directors or other similar governing body if one exists.

.102 The written communications referred to in paragraphs .100–.101 should be made by the report release date,[26] which is the date the auditor grants the entity permission to use the auditor's report. For a governmental entity, the auditor is not required to make the written communications by the report release date, if such written communications would be publicly available prior to management's report on internal control, the entity's financial statements, and the auditor's report thereon. In that circumstance, the written communications should be made as soon as practicable, but no later than 60 days following the report release date.

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[25] See paragraph .117 when the scope of the engagement has been restricted.

[26] See paragraph .A2 of AU-C section 230, *Audit Documentation*, for additional guidance related to the report release date. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.103 Because of the importance of timely communication, the auditor may choose to communicate significant matters during the course of the integrated audit. If the communication is made during the integrated audit, the form of interim communication would be affected by the relative significance of the identified deficiencies and the urgency for corrective follow-up action. Such early communication is not required to be in writing. However, regardless of how the early communication is delivered, the auditor should communicate all significant deficiencies and material weaknesses in writing to management and those charged with governance in accordance with paragraphs .100–.102, even if the significant deficiencies or material weaknesses were remediated during the examination.

.104 The auditor also should communicate to management, in writing, all deficiencies (those deficiencies that are not material weaknesses or significant deficiencies) identified during the integrated audit on a timely basis, but no later than 60 days following the report release date, and inform those charged with governance when such a communication was made. In making the written communication referred to in this paragraph, the auditor is not required to communicate those deficiencies that are not material weaknesses or significant deficiencies that were included in previous written communications, whether those communications were made by the auditor, internal auditors, or others within the organization.

.105 The auditor is not required to perform procedures that are sufficient to identify all deficiencies; rather, the auditor communicates deficiencies of which he or she is aware.

.106 Because the integrated audit does not provide the auditor with assurance that he or she has identified all deficiencies less severe than a material weakness, the auditor should not issue a report stating that no such deficiencies were identified during the integrated audit. Also, because the auditor's objective in an examination of internal control is to form an opinion on the effectiveness of the entity's internal control, the auditor should not issue a report indicating that no material weaknesses were identified during the integrated audit.

Reporting on Internal Control

.107 The auditor's report on the examination of internal control should include the following elements:[27]

a. A title that includes the word *independent*

b. A statement that management is responsible for maintaining effective internal control and for evaluating the effectiveness of internal control

c. An identification of management's assertion on internal control that accompanies the auditor's report, including a reference to management's report

d. A statement that the auditor's responsibility is to express an opinion on the entity's internal control (or on management's assertion)[28] based on his or her examination[29]

e. A statement that the examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants

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[27] Report modifications are discussed further beginning at paragraph .115.

[28] The auditor may report directly on the entity's internal control or on management's written assertion, except as described in paragraph .112.

[29] Because the examination of internal control is integrated with the audit of the financial statements and an examination provides the same level of assurance as an audit, the auditor may refer to the examination of internal control as an audit in his or her report or other communications.

f. A statement that such standards require that the auditor plan and perform the examination to obtain reasonable assurance about whether effective internal control was maintained in all material respects

g. A statement that an examination includes obtaining an understanding of internal control, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as the auditor considers necessary in the circumstances

h. A statement that the auditor believes the examination provides a reasonable basis for his or her opinion

i. A definition of internal control (the auditor should use the same description of the entity's internal control as management uses in its report)

j. A paragraph stating that, because of inherent limitations, internal control may not prevent, or detect and correct misstatements and that projections of any evaluation 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

k. The auditor's opinion on whether the entity maintained, in all material respects, effective internal control as of the specified date, based on the control criteria; or, the auditor's opinion on whether management's assertion about the effectiveness of the entity's internal control as of the specified date is fairly stated, in all material respects, based on the control criteria

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

m. The date of the report

Separate or Combined Reports

.108 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 internal control) or separate reports on the entity's financial statements and on internal control.

.109 If the auditor issues a separate report on internal control, he or she should add the following paragraph to the auditor's report on the financial statements:

> We also have examined [*or audited*][30] in accordance with attestation standards established by the American Institute of Certified Public Accountants, [*company name*]'s internal control over financial reporting as of December 31, 20X8, based on [*identify control criteria*] and our report dated [*date of report, which should be the same as the date of the report on the financial statements*] expressed [*include nature of opinion*].

The auditor also should add the following paragraph to the report on internal control:

> We also have audited, in accordance with auditing standards generally accepted in the United States of America, the [*identify financial statements*] of [*company name*] and our report dated [*date of report, which should be the same as the date of the report on internal control*] expressed [*include nature of opinion*].

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[30] See footnote 29.

Report Date

.110 The auditor should date the report no earlier than the date on which the auditor has obtained sufficient appropriate evidence to support the auditor's opinion. Because the examination of internal control is integrated with the audit of the financial statements, the dates of the reports should be the same.

Adverse Opinions

.111 Paragraphs .82–.92 describe the evaluation of deficiencies. If there are deficiencies that, individually or in combination, result in one or more material weaknesses as of the date specified in management's assertion, the auditor should express an adverse opinion on the entity's internal control, unless there is a restriction on the scope of the engagement.[31]

.112 When internal control is not effective because one or more material weaknesses exist, the auditor is prohibited from expressing an opinion on management's assertion and should report directly on the effectiveness of internal control. In addition, the auditor's report should include

- the definition of a material weakness.
- a statement that one or more material weaknesses have been identified and an identification of the material weaknesses described in management's assertion. 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 the following paragraph.

.113 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, which should provide the users of the report with 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.

.114 The auditor should determine the effect an adverse opinion on internal control has on his or her opinion on the financial statements. Additionally, the auditor should disclose whether his or her opinion on the financial statements was affected by the material weaknesses.[32]

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[31] See paragraph .117 when the scope of the engagement has been restricted.

[32] If the auditor issues a separate report on internal control in this circumstance, the disclosure required by this paragraph may be combined with the report language described in paragraph .109. The auditor may present the combined language either as a separate paragraph or as part of the paragraph that identifies the material weakness.

Report Modifications

.115 The auditor should modify his or her report if any of the following conditions exist:

a. Elements of management's report are incomplete or improperly presented.

b. There is a restriction on the scope of the engagement.

c. The auditor decides to refer to the report of a component auditor as the basis, in part, for the auditor's own report.

d. There is other information contained in management's report.

[Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Elements of Management's Report Are Incomplete or Improperly Presented

.116 If the auditor determines that any required element of management's report (see paragraph .95) is incomplete or improperly presented and management does not revise its report, the auditor should modify his or her report to include an explanatory paragraph describing the reasons for this determination. If the auditor determines that the required disclosure about one or more material weaknesses is not fairly presented in all material respects, the auditor should apply paragraph .113.

Scope Limitations

.117 The auditor may express an opinion on the entity's internal control only if the auditor has been able to apply the procedures necessary in the circumstances. If there are restrictions on the scope of the engagement, the auditor should withdraw from the engagement or disclaim an opinion.

.118 When disclaiming an opinion because of a scope limitation, the auditor should state that he or she does not express an opinion on the effectiveness of internal control and, in a separate paragraph or paragraphs, the substantive reasons for the disclaimer. The auditor should not identify the procedures that were performed nor include the statements describing the characteristics of an examination of internal control (paragraph .107[d–h]); to do so might overshadow the disclaimer.

.119 When the auditor plans to disclaim an opinion and the limited procedures performed by the auditor caused the auditor to conclude that one or more material weaknesses exist, the auditor's report also should include

- the definition of a material weakness.
- a description of any material weaknesses identified in the entity's internal control. This description should address the requirements in paragraph .112 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 .114.

.120 The auditor may issue a report disclaiming an opinion on internal control as soon as the auditor concludes that a scope limitation will prevent the auditor from obtaining the reasonable assurance necessary to express an opinion.[33] The auditor is not required to perform any additional work prior to issuing a disclaimer when the auditor concludes that he or she will not be able to obtain sufficient appropriate evidence to express an opinion.

.121 If the auditor concludes that he or she cannot express an opinion because there has been a limitation on the scope of the examination, the auditor should communicate, in writing, to management and those charged with governance that the examination of internal control cannot be satisfactorily completed.

Opinion Based, in Part, on the Report of a Component Auditor

.122 When an entity is composed of one or more components (for example, subsidiaries, divisions, or branches), and another auditor has examined the internal control of one or more of the components, the auditor should determine whether it is appropriate to serve as the auditor of the group's internal control and use the work and reports of the component auditor as a basis, in part, for the auditor's opinion. The auditor considering whether to serve as the auditor of the group's internal control may have performed all but a relatively minor portion of the work, or the component auditor may have performed significant parts of the examination. In the latter case, the auditor should decide whether the auditor's own involvement is sufficient to enable the auditor to serve as the auditor of the group's internal control and to report on internal control as such. In deciding this question, the auditor should consider, among other things, the materiality of the portion of internal control the auditor has examined in comparison with the portion examined by the component auditor, the extent of the auditor's knowledge of overall internal control, and the importance of the components examined by the auditor in relation to the group as a whole. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.123 If the auditor decides that it is appropriate to serve as the auditor of the group's internal control, the auditor should then decide whether to make reference in his or her report on the group's internal control to the examination of internal control performed by the component auditor. If the auditor decides to assume responsibility for the work of the component auditor insofar as that work relates to the expression of an opinion on the group's internal control taken as a whole, no reference should be made to the component auditor's work or report. On the other hand, if the auditor decides not to assume responsibility, the auditor's report should make reference to the examination of the component auditor and should clearly indicate the division of responsibility between the auditor and the component auditor in expressing an opinion on the group's internal control. Regardless of the auditor's decision, the auditor remains responsible for the performance of his or her own work and report. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.124 The decision about whether to make reference to a component auditor in the report on the examination of internal control might differ from the corresponding decision as it relates to the audit of the financial statements. For example, the audit report on the financial statements may make reference to

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[33] In this case, in following paragraph .110 regarding dating the report, the report date is the date that the auditor has obtained sufficient appropriate evidence to support the representations in the report.

the audit of a significant equity investment performed by a component auditor[34] but the report on internal control might not make a similar reference because management's assertion ordinarily would not extend to controls at the equity method investee.[35] [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.125 When the auditor of the group's internal control decides to make reference to the report of the component auditor as a basis, in part, for the auditor's opinion on the group's internal control, the auditor should refer to the report of the component auditor when describing the scope of the examination and when expressing the opinion. Whether the component auditor's opinion is expressed on management's assertion or on internal control does not affect the determination of whether the opinion of the auditor of the group's internal control is expressed on management's assertion or on internal control. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Management's Report Contains Additional Information

.126 Management's report accompanying the auditor's report may contain information in addition to the elements described in paragraph .95 that are subject to the auditor's evaluation.[36] If management's report could reasonably be viewed by users of the report as including such additional information, the auditor should disclaim an opinion on the information.

.127 The auditor may use the following sample language as the last paragraph of the auditor's report to disclaim an opinion on such additional information:

> We do not express an opinion or any other form of assurance on [*describe additional information, such as management's cost-benefit statement*].

.128 If the auditor believes that management's additional information contains a material misstatement of fact, he or she should apply the guidance in paragraphs .92–.94 of section 101 and take appropriate action. If the auditor concludes that a material misstatement of fact remains, the auditor should notify management and those charged with governance, in writing, of the auditor's views concerning the information. AU-C section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, also may require the auditor to take additional action. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

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[34] AU-C section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors*, addresses special considerations that apply to group audits, in particular those that involve component auditors. [Footnote added, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

[35] See paragraph .140 for further discussion of the evaluation of the controls for an equity method investment.[Footnote renumbered, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

[36] An entity may publish various documents that contain information in addition to management's report and the auditor's report on internal control. Paragraphs .91–.94 of section 101 provide guidance to the auditor in these circumstances. If management makes the types of disclosures described in paragraph .126 outside its report and includes them elsewhere within a document that includes the auditor's report, the auditor would not need to disclaim an opinion on such information. However, in that situation, the auditor's responsibilities are the same as those described in paragraph .128, if the auditor believes that the additional information contains a material misstatement of fact. [Footnote renumbered, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Subsequent Events

.129 Changes in internal control or other factors that might significantly affect internal control might occur subsequent to the date as of which internal control is being examined but before the date of the auditor's report. The auditor should inquire of management whether there were any such changes or factors and obtain written representations from management relating to such matters, as described in paragraph .97.

.130 To obtain additional information about changes in internal control or other factors that might significantly affect the effectiveness of the entity's internal control, the auditor should inquire about and examine, for this subsequent period, the following:

- Relevant internal audit (or similar functions, such as loan review in a financial institution) reports issued during the subsequent period
- Independent auditor reports (if other than the auditor's) of deficiencies
- Regulatory agency reports on the entity's internal control
- Information about the effectiveness of the entity's internal control obtained through other engagements

.131 The auditor might inquire about and examine other documents for the subsequent period. AU-C section 560, *Subsequent Events and Subsequently Discovered Facts*, establishes requirements and provides guidance on subsequent events for a financial statement audit that also may be helpful to the auditor performing an examination of internal control. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.132 If, subsequent to the date as of which internal control is being examined but before the date of the auditor's report, the auditor obtains knowledge about a material weakness that existed as of the date specified in management's assertion, the auditor should report directly on internal control and issue an adverse opinion, as required by paragraph .111. The auditor should also follow paragraph .116 if management's assertion states that internal control is effective. If the auditor is unable to determine the effect of the matter on the effectiveness of the entity's internal control as of the date specified in management's assertion, the auditor should disclaim an opinion. As described in paragraph .126, the auditor should disclaim an opinion on management's disclosures about corrective actions taken by the entity, if any.

.133 The auditor may obtain knowledge about conditions that did not exist at the date specified in management's assertion but arose subsequent to that date and before the release of the auditor's report. If a subsequent event of this type has a material effect on the entity's internal control, the auditor should include in his or her report an explanatory paragraph describing the event and its effects or directing the reader's attention to the event and its effects as disclosed in management's report.

.134 The auditor has no responsibility to keep informed of events subsequent to the date of his or her report; however, after the release of the report on internal control, the auditor may become aware of conditions that existed at the report date that might have affected the auditor's opinion had he or she been aware of them. The evaluation of such subsequent information is similar to the evaluation of facts discovered subsequent to the date of the report on an audit of financial statements, as described in AU-C section 560. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Special Topics

Entities With Multiple Locations

.135 In determining the locations or business units at which to perform tests of controls, the auditor should assess the risk of material misstatement to the financial statements associated with the location or business unit and correlate the amount of attention devoted to the location or business unit with the degree of risk. The auditor may eliminate from further consideration locations or business units that, individually or when aggregated with others, do not present a reasonable possibility of material misstatement to the entity's consolidated financial statements.

.136 In assessing and responding to risk, the auditor should test controls over specific risks that present a reasonable possibility of material misstatement to the entity's consolidated financial statements. In lower risk locations or business units, the auditor first might evaluate whether testing entity-level controls, including controls in place to provide assurance that appropriate controls exist throughout the organization, provides the auditor with sufficient appropriate evidence.

.137 In determining the locations or business units at which to perform tests of controls, the auditor may take into account work performed by others on behalf of management. For example, if the internal auditors' planned procedures include relevant audit work at various locations, the auditor may coordinate work with the internal auditors and reduce the number of locations or business units at which the auditor would otherwise need to perform examination procedures.

.138 In applying the requirement in paragraph .81 regarding special considerations for subsequent years' examinations, the auditor should vary the nature, timing, and extent of testing of controls at locations or business units from year to year.

Special Situations

.139 The scope of the examination should include entities that are acquired on or before the date of management's assertion and operations that are accounted for as discontinued operations on the date of management's assertion that are reported in accordance with the applicable financial reporting framework in the entity's financial statements.

.140 For equity method investments, the scope of the examination should include controls over the reporting in accordance with the applicable financial reporting framework, in the entity's financial statements, of the entity's portion of the investees' income or loss, the investment balance, adjustments to the income or loss and investment balance, and related disclosures. The examination ordinarily would not extend to controls at the equity method investee.

.141 In situations in which a regulator allows management to limit its assertion by excluding certain entities, the auditor may limit the examination in the same manner. In these situations, the auditor's opinion would not be affected by a scope limitation. However, the auditor should include, either in an additional explanatory paragraph or as part of the scope paragraph in his or her report, a disclosure similar to management's regarding the exclusion of an entity from the scope of both management's assertion and the auditor's examination of internal control. Additionally, the auditor should evaluate the reasonableness of management's conclusion that the situation meets the criteria of the regulator's allowed exclusion and the appropriateness of any required disclosure related to such a limitation. If the auditor believes that management's disclosure about the limitation requires modification, the auditor should communicate the matter to the appropriate level of management. If, in the auditor's judgment, management does not respond appropriately to the auditor's communication within a reasonable period of time, the auditor should inform those charged with governance of the matter as soon as practicable. If management and those charged with governance do not respond appropriately, the auditor should modify his or her report on the examination of internal control to include an explanatory paragraph describing the reasons why the auditor believes management's disclosure requires modification.

Use of Service Organizations

.142 AU-C section 402 [37] addresses an auditor's responsibility for obtaining sufficient appropriate audit evidence in an audit of the financial statements of an entity that uses one or more service organizations (a user entity). Services provided by a service organization are relevant to the audit of a user entity's financial statements when those services and the controls over them affect the user entity's information system. The auditor may apply the relevant concepts described in AU-C section 402 to the examination of internal control. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.143 Paragraph .03 of AU-C section 402 identifies the situations in which a service organization's services and controls over them are part of a user entity's information system. If the service organization's services are part of the user entity's information system, as described therein, then they are part of the user entity's internal control. When the service organization's services are part of the user entity's internal control, the auditor should consider the activities of the service organization when determining the evidence required to support his or her opinion. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.144 The auditor should perform the procedures in paragraphs .09–.19 of AU-C section 402 with respect to the activities performed by the service organization. These procedures include

a. obtaining an understanding of the how the user entity uses the services of the service organization in its operations,

b. evaluating the design and implementation of relevant controls at the user entity that relate to the services provided by the service organization), and

c. obtaining evidence that controls at the service organization that are relevant to the auditor's opinion on internal control are operating effectively.

[Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.145 Evidence that the controls that are relevant to the auditor's opinion on internal control are operating effectively may be obtained by following the

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[37] AU-C section 402, *Audit Considerations Relating to an Entity Using a Service Organization*, contains the requirements and application guidance for auditors of the financial statements of entities that use a service organization (user auditors). [Footnote added, August 2011, to reflect conforming changes necessary due to the issuance of SSAE No. 16. Footnote renumbered and revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

procedures described in paragraphs .16–.17 of AU-C section 402. These procedures include one or more of the following:

a. Obtaining and reading a service auditor's report on management's description of a service organization's system and the suitability of the design and operating effectiveness of controls, which includes a description of the service auditor's tests of controls and results (a type 2 report),[38] if available

b. Performing appropriate tests of controls at the service organization

c. Using another auditor to perform tests of controls at the service organization on behalf of the auditor

[Revised, August 2011, to reflect conforming changes necessary due to the issuance of SSAE No. 16. Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.146 If the auditor plans to use a type 2 report as audit evidence that controls are operating effectively, the auditor should determine whether the type 2 report provides sufficient appropriate audit evidence about the effectiveness of the controls to support his or her opinion on internal control by evaluating[39]

- the time period covered by the tests of controls and its relation to the as-of date of management's assertion.
- the scope of the services auditor's work and the services and processes covered, the controls tested, and the tests that were performed and the way in which tested controls relate to the entity's controls.
- the results of those tests of controls and the service auditor's opinion on the operating effectiveness of the controls.

[Revised, August 2011, to reflect conforming changes necessary due to the issuance of SSAE No. 16. Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.147 If the service auditor's type 2 report contains a statement indicating that the control objectives stated in the description can be achieved only if complementary user entity controls are suitably designed and operating effectively, along with the controls at the service organization, the auditor should determine whether the entity has designed and implemented such controls and, if so, should test their operating effectiveness. [Revised, August 2011, to reflect conforming changes necessary due to the issuance of SSAE No. 16. Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.148 In determining whether the type 2 service auditor's report provides sufficient appropriate evidence to support the auditor's opinion on internal control, the auditor should be satisfied regarding the following:

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[38] A report on management's description of a service organization's system and the suitability of the design of controls (a type 1 report) does not include a description of the service auditor's tests of controls and results of those tests or the service auditor's opinion on the operating effectiveness of controls and therefore does not provide evidence of the operating effectiveness of controls. Type 1 and type 2 reports are defined in paragraph .07 of section 801, *Reporting on Controls at a Service Organization*. [Footnote renumbered and revised, August 2011, to reflect conforming changes necessary due to the issuance of SSAE No. 16. Footnote renumbered, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

[39] These factors are similar to factors the auditor would consider in determining whether the report provides sufficient appropriate evidence to support the auditor's assessed level of control risk in an audit of the financial statements, as described in paragraph .A32 of AU-C section 402. [Footnote renumbered, August 2011, to reflect conforming changes necessary due to the issuance of SSAE No. 16. Footnote renumbered and revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

- The service auditor's professional competence and independence from the service organization. Appropriate sources of information concerning the service auditor's professional competence and independence are discussed in paragraphs .A21–.A22 of AU-C section 402.
- The adequacy of the standards under which the type 2 report was issued.

[Revised, August 2011, to reflect conforming changes necessary due to the issuance of SSAE No. 16. Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.149 When a significant period of time has elapsed between the time period covered by the tests of controls in the service auditor's report and the date specified in management's assertion, additional procedures should be performed. The auditor should inquire of management to determine whether management has identified any changes in the service organization's controls subsequent to the period covered by the service auditor's report (such as changes communicated to management from the service organization, changes in personnel at the service organization with whom management interacts, changes in reports or other data received from the service organization, changes in contracts or service level agreements with the service organization, or errors identified in the service organization's processing). If management has identified such changes, the auditor should evaluate the effect of such changes on the effectiveness of the entity's internal control. The auditor also should evaluate whether the results of other procedures he or she performed indicate that there have been changes in the controls at the service organization.

.150 As risk increases, the need for the auditor to obtain additional evidence increases. Accordingly, the auditor should determine whether to obtain additional evidence about the operating effectiveness of controls at the service organization based on the procedures performed by management or the auditor and the results of those procedures and on an evaluation of the following risk factors:

- The elapsed time between the time period covered by the tests of controls in the service auditor's report and the date specified in management's assertion
- The significance of the activities of the service organization
- Whether there are errors that have been identified in the service organization's processing
- The nature and significance of any changes in the service organization's controls identified by management or the auditor

.151 If the auditor concludes that additional evidence about the operating effectiveness of controls at the service organization is required, the auditor's additional procedures might include

- evaluating procedures performed by management and the results of those procedures.
- contacting the service organization, through the user entity, to obtain specific information.
- requesting that a service auditor be engaged to perform procedures that will supply the necessary information.
- visiting the service organization and performing such procedures.

.152 The auditor should not refer to the service auditor's report when expressing an opinion on internal control.

Benchmarking of Automated Controls

.153 Entirely automated application controls are generally less susceptible to breakdowns due to human failure. This feature may allow the auditor to use a benchmarking strategy.

.154 If general controls over program changes, access to programs, and computer operations are effective and continue to be tested, and if the auditor verifies that the automated application control has not changed since the auditor established a baseline (that is, last tested the application control), the auditor may conclude that the automated application control continues to be effective without repeating the prior year's specific tests of the operation of the automated application control. The nature and extent of the evidence that the auditor should obtain to verify that the control has not changed may vary depending on the circumstances, including the strength of the entity's program change controls.

.155 The consistent and effective functioning of the automated application controls may be dependent upon the related files, tables, data, and parameters. For example, an automated application for calculating interest income might be dependent on the continued integrity of a rate table used by the automated calculation.

.156 To determine whether to use a benchmarking strategy, the auditor should assess the following risk factors. As these factors indicate lower risk, the control being evaluated might be well-suited for benchmarking. As these factors indicate increased risk, the control being evaluated is less suited for benchmarking. These factors are

- the extent to which the application control can be matched to a defined program within an application.
- the extent to which the application is stable (that is, there are few changes from period to period).
- the availability and reliability of a report of the compilation dates of the programs placed in production. (This information may be used as evidence that controls within the program have not changed.)

.157 Benchmarking automated application controls can be especially effective for entities using purchased software when the possibility of program changes is remote (for example, when the vendor does not allow access or modification to the source code).

.158 After a period of time, the length of which depends upon the circumstances, the baseline of the operation of an automated application control should be reestablished. To determine when to reestablish a baseline, the auditor should evaluate the following factors:

- The effectiveness of the IT control environment, including controls over application and system software acquisition and maintenance, access controls, and computer operations.
- The auditor's understanding of the nature of changes, if any, on the specific programs that contain the controls.
- The nature and timing of other related tests.
- The consequences of errors associated with the application control that was benchmarked.
- Whether the control is sensitive to other business factors that may have changed. For example, an automated control may have been

designed with the assumption that only positive amounts will exist in a file. Such a control would no longer be effective if negative amounts (credits) begin to be posted to the account.

Integration With the Financial Statement Audit

Tests of Controls in an Examination of Internal Control

.159 The objective of the tests of controls in an examination of internal control is to obtain evidence about the effectiveness of controls to support the auditor's opinion on the entity's internal control. The auditor's opinion relates to the effectiveness of the entity's internal control as of a point in time and taken as a whole.

.160 To express an opinion on internal control as of a point in time, the auditor should obtain evidence that internal control has operated effectively for a sufficient period of time, which may be less than the entire period (ordinarily one year) covered by the entity's financial statements. To express an opinion on internal control taken as a whole, the auditor should obtain evidence about the effectiveness of selected controls over all relevant assertions. This entails testing the design and operating effectiveness of controls ordinarily not tested when expressing an opinion only on the financial statements.

.161 When concluding on the effectiveness of internal control for purposes of expressing an opinion on internal control, the auditor should incorporate the results of any additional tests of controls performed to achieve the objective related to expressing an opinion on the financial statements, as discussed in the following section.

Tests of Controls in an Audit of Financial Statements

.162 To express an opinion on the financial statements, the auditor ordinarily performs tests of controls and substantive procedures. Tests of controls are performed when the auditor's risk assessment includes an expectation of the operating effectiveness of controls or when substantive procedures alone do not provide sufficient appropriate audit evidence at the relevant assertion level.[40] Tests of controls are designed to obtain sufficient appropriate audit evidence that the controls are operating effectively throughout the period of reliance.[41] However, the auditor is not required to test controls for all relevant assertions and, for a variety of reasons, the auditor may choose not to do so.

.163 When concluding on the effectiveness of controls for the purpose of the financial statement audit, the auditor also should evaluate the results of any additional tests of controls performed by the auditor to achieve the objective related to expressing an opinion on the entity's internal control, as discussed in paragraph .160. Consideration of these results may cause the auditor to alter the nature, timing, and extent of substantive procedures and to plan and perform further tests of controls, particularly in response to identified deficiencies.

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[40] See paragraph .18 of AU-C section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*. [Footnote renumbered, August 2011, to reflect conforming changes necessary due to the issuance of SSAE No. 16. Footnote renumbered and revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

[41] See paragraph .11 of AU-C section 330. [Footnote renumbered, August 2011, to reflect conforming changes necessary due to the issuance of SSAE No. 16. Footnote renumbered and revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126. Footnote revised, July 2013, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Effect of Tests of Controls on Substantive Procedures

.164 If, during the examination of internal control, the auditor identifies a deficiency, he or she should determine the effect of the deficiency, if any, on the nature, timing, and extent of substantive procedures to be performed to reduce audit risk in the audit of the financial statements to an appropriately low level.

.165 Regardless of the assessed risk of material misstatement in connection with the audit of the financial statements, the auditor should perform substantive procedures for all relevant assertions related to each material class of transactions, account balance, and disclosure.[42] Performing procedures to express an opinion on internal control does not diminish this requirement. [Footnote renumbered, August 2011, to reflect conforming changes necessary due to the issuance of SSAE No. 16.]

Effect of Substantive Procedures on Conclusions About the Operating Effectiveness of Controls

.166 In an examination of internal control, the auditor should evaluate the effect of the findings of the substantive procedures performed in the audit of financial statements on the effectiveness of internal control. This evaluation should include, at a minimum

- the risk assessments in connection with the selection and application of substantive procedures, especially those related to fraud.
- findings with respect to illegal acts and related party transactions.
- indications of management bias in making accounting estimates and in selecting accounting principles.
- misstatements detected by substantive procedures. The extent of such misstatements might alter the auditor's judgment about the effectiveness of controls.

.167 To obtain evidence about whether a selected control is effective, the control should be tested directly; the operating effectiveness of a control cannot be inferred from the absence of misstatements detected by substantive procedures. The absence of misstatements detected by substantive procedures, however, may affect the auditor's risk assessments in determining the testing necessary to conclude on the operating effectiveness of a control.

Effective Date

.168 This section is effective for integrated audits for periods ending on or after December 15, 2008. Earlier implementation is permitted.

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[42] See paragraphs .18 and .A45 of AU-C section 330. [Footnote renumbered, August 2011, to reflect conforming changes necessary due to the issuance of SSAE No. 16. Footnote renumbered and revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

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Exhibit A—Illustrative Reports

1. The following illustrate the report elements described in this section. These illustrative reports refer to an examination; however, the auditor may refer to the examination of internal control as an audit.[1]

2. Report modifications are discussed beginning at paragraph .115 of this section.

Example 1: Unqualified Opinion on Internal Control

3. The following is an illustrative report expressing an unqualified opinion directly on internal control.

Independent Auditor's Report

[*Introductory paragraph*]

We have examined W Company's internal control over financial reporting as of December 31, 20XX, based on [*identify criteria*].[2] W Company's management is responsible for maintaining effective internal control over financial reporting, and for its assertion about the effectiveness of internal control over financial reporting, included in the accompanying [*title of management's report*]. Our responsibility is to express an opinion on W Company's internal control over financial reporting based on our examination.

[*Scope paragraph*]

We conducted our examination in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our examination included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our examination also included performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

[*Definition paragraph*]

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

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[1] Because the examination of internal control is integrated with the audit of the financial statements and an examination provides the same level of assurance as an audit, the auditor may refer to the examination of internal control as an audit in his or her report or other communications.

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

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.

[*Inherent limitations paragraph*]

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct misstatements. Also, projections of any evaluation 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 paragraph*]

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

[*Audit of financial statements paragraph*]

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

[*Signature*]

[*Date*]

Example 2: Unqualified Opinion on Management's Assertion

4. The following is an illustrative report expressing an unqualified opinion on management's assertion.

Independent Auditor's Report

[*Introductory paragraph*]

We have examined management's assertion, included in the accompanying [*title of management report*], that W Company maintained effective internal control over financial reporting as of December 31, 20XX based on [*identify criteria*].[3] W Company's management is responsible for maintaining effective internal control over financial reporting, and for its assertion about the effectiveness of internal control over financial reporting, included in the accompanying [*title of management's report*]. Our responsibility is to express an opinion on management's assertion based on our examination.

[*Scope paragraph*]

We conducted our examination in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the examination to obtain reasonable

[3] See footnote 2 of this exhibit.

assurance about whether effective internal control over financial reporting was maintained in all material respects. Our examination included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our examination also included performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

[*Definition paragraph*]

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.

[*Inherent limitations paragraph*]

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct misstatements. Also, projections of any evaluation 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 paragraph*]

In our opinion, management's assertion that W Company maintained effective internal control over financial reporting as of December 31, 20XX is fairly stated, in all material respects, based on [*identify criteria*].

[*Audit of financial statements paragraph*]

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

[*Signature*]

[*Date*]

Example 3: Adverse Opinion on Internal Control

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

Independent Auditor's Report

[*Introductory paragraph*]

We have examined W Company's internal control over financial reporting as of December 31, 20XX, based on [*identify criteria*].[4] W Company's management is responsible for maintaining effective internal control over financial reporting, and for its assertion about the effectiveness of internal control over financial reporting, included in the accompanying [*title of management's report*]. Our responsibility is to express an opinion on W Company's internal control over financial reporting based on our examination.

[*Scope paragraph*]

We conducted our examination in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our examination included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our examination also included performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

[*Definition paragraph*]

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.

[*Inherent limitations paragraph*]

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct misstatements. Also, projections of any evaluation 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.

[*Explanatory paragraph*]

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility

[4] See footnote 2 of this exhibit.

that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. The following material weakness has been identified and included in the accompanying [*title of management's report*].

[*Identify the material weakness described in management's report.*][5]

[*Opinion paragraph*]

In our opinion, because of the effect of the material weakness described above on the achievement of the objectives of the control criteria, W Company has not maintained effective internal control over financial reporting as of December 31, 20XX, based on [*identify criteria*].

[*Audit of financial statements paragraph*]

We also have audited, in accordance with auditing standards generally accepted in the United States of America, the [*identify financial statements*] of W Company. We considered the material weakness identified above in determining the nature, timing, and extent of audit tests applied in our audit of the 20XX financial statements, and this report does not affect our report dated [*date of report, which should be the same as the date of the report on the examination of internal control*], which expressed [*include nature of opinion*].

[*Signature*]

[*Date*]

Example 4: Disclaimer of Opinion on Internal Control

6. The following is an illustrative report expressing a disclaimer of opinion on internal control. In this example, the auditor is applying paragraph .119 of this section because a material weakness was identified during the limited procedures performed by the auditor.

<u>Independent Auditor's Report</u>

[*Introductory paragraph*]

We were engaged to examine W Company's internal control over financial reporting as of December 31, 20XX, based on [*identify criteria*].[6] W Company's management is responsible for maintaining effective internal control over financial reporting, and for its assertion about the effectiveness of internal control over financial reporting, included in the accompanying [*title of management's report*].

[*Paragraph that describes the substantive reasons for the scope limitation*] Accordingly, we were unable to perform auditing procedures necessary to form an opinion on W Company's internal control over financial reporting as of December 31, 20XX.

[*Definition paragraph*]

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed

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[5] See paragraphs .111–.114 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.

[6] See footnote 2 of this exhibit.

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.

[*Inherent limitations paragraph*]

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct misstatements. Also, projections of any evaluation 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.

[*Explanatory paragraph*]

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 identified and 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.*]

[*Opinion paragraph*]

Because of the limitation on the scope of our audit described in the second paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the effectiveness W Company's internal control over financial reporting.

[*Audit of financial statements paragraph*]

We have audited, in accordance with auditing standards generally accepted in the United States of America, the [*identify financial statements*] of W Company and our report dated [*date of report*] expressed [*include nature of opinion*]. We considered the material weakness identified above in determining the nature, timing, and extent of audit tests applied in our audit of the 20XX financial statements, and this report does not affect such report on the financial statements.

[*Signature*]

[*Date*]

Example 5: Unqualified Opinion on Internal Control Based, in Part, on the Report of Another Auditor

7. The following is an illustrative report expressing an unqualified opinion on internal control when the auditor decides to refer to the report of another auditor as the basis, in part, for the auditor's own report.

Independent Auditor's Report

[*Introductory paragraph*]

We have examined W Company's internal control over financial reporting as of December 31, 20XX, based on [*identify criteria*].[7] W Company's management is responsible for maintaining effective internal control over financial reporting, and for its assertion about the effectiveness of internal control over financial reporting, included in the accompanying [*title of management's report*]. Our responsibility is to express an opinion on W Company's internal control over financial reporting based on our examination. We did not examine 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 examined 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.

[*Scope paragraph*]

We conducted our examination in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our examination included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our examination also included performing such other procedures as we considered necessary in the circumstances. We believe that our examination and the report of the other auditors provide a reasonable basis for our opinion.

[*Definition paragraph*]

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

[7] See footnote 2 of this exhibit.

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.

[*Inherent limitations paragraph*]

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct misstatements. Also, projections of any evaluation 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 paragraph*]

In our opinion, based on our examination and the report of the other auditors, W Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 20XX, based on [*identify criteria*].[8]

[*Audit of financial statements paragraph*]

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

[*Signature*]

[*Date*]

Example 6: Combined Report Expressing an Unqualified Opinion on Internal Control and an Unmodified Opinion on the Financial Statements

8. The following is an illustrative combined report expressing an unqualified opinion directly on internal control and an unmodified opinion on the financial statements. This report refers to the examination of internal control as an audit.[9]

Independent Auditor's Report

[*Appropriate Addressee*]

We have audited the accompanying financial statements of W Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholder's equity, and cash flows for the year then ended, and the related notes to the financial statements. We also have audited W Company's internal control over financial reporting as of December 31, 20XX, based on [*identify criteria*].[10]

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

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of effective internal control over financial reporting relevant to the preparation and fair presentation of these financial statements that are

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[8] As discussed in paragraph .125 of this section, whether the other auditor's opinion is expressed on management's assertion or on internal control does not affect the determination of whether the principal auditor's opinion is expressed on management's assertion or on internal control.

[9] See footnote 1 of this exhibit.

[10] See footnote 2 of this exhibit.

free from material misstatement, whether due to error of fraud. Management is also responsible for its assertion about the effectiveness of internal control over financial reporting, included in the accompanying [*title of management's report*].

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements and an opinion on W Company's internal control over financial reporting based on our audits. We conducted our audit of the financial statements in accordance with auditing standards generally accepted in the United States of America and our audit of internal control over financial reporting in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement and whether effective internal control over financial reporting was maintained in all material respects.

An audit of financial statements involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. An audit of financial statements also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. An audit of internal control over financial reporting involves obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control over financial reporting based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances.

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

Definitions 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 evaluation 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 W 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, W Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 20XX, based on [*identify criteria*].

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

[Revised, December 2012 and July 2013, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

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Exhibit B—Illustrative Communication of Significant Deficiencies and Material Weaknesses

1. The following is an illustrative written communication of significant deficiencies and material weaknesses.

> In connection with our audit of W Company's (the "Company") financial statements as of December 31, 20XX and for the year then ended, and our audit of the Company's internal control over financial reporting as of December 31, 20XX ("integrated audit"), the standards established by the American Institute of Certified Public Accountants require that we advise you of the following internal control matters identified during our integrated audit.
>
> Our responsibility is to plan and perform our integrated audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud, and whether effective internal control over financial reporting was maintained in all material respects (that is, whether material weaknesses exist as of the date specified in management's assertion). The integrated audit is not designed to detect deficiencies that, individually or in combination, are less severe than a material weakness. However, we are responsible for communicating to management and those charged with governance significant deficiencies and material weaknesses identified during the integrated audit. We are also responsible for communicating to management deficiencies that are of a lesser magnitude than a significant deficiency, unless previously communicated, and inform those charged with governance when such a communication was made.
>
> A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. [*A 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 Company's financial statements will not be prevented, or detected and corrected on a timely basis. We believe the following deficiencies constitute material weaknesses:*]
>
> [*Describe the material weaknesses that were identified during the integrated audit. The auditor may separately identify those material weaknesses that exist as of the date of management's assertion by referring to the auditor's report.*]
>
> [*A significant deficiency is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the following deficiencies to be significant deficiencies:*]
>
> [*Describe the significant deficiencies that were identified during the integrated audit.*]
>
> This communication is intended solely for the information and use of management, [*identify the body or individuals charged with governance*], others within the organization, and [*identify any specified governmental authorities*] and is not intended to be and should not be used by anyone other than these specified parties.

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Exhibit C—Reporting Under Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA)

1. In Financial Institution Letter (FIL) 86-94, *Additional Guidance Concerning Annual Audits, Audit Committees and Reporting Requirements*, issued December 23, 1994, the Federal Deposit Insurance Corporation (FDIC) provided guidance on the meaning of the term *financial reporting* for purposes of compliance by insured depository institutions (IDIs) with Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) (Section 36 of the Federal Deposit Insurance Act, 12.U.S.C. 1831m), and its implementing regulation, 12 CFR Part 363. The FDIC indicated that financial reporting, at a minimum, includes financial statements prepared in accordance with generally accepted accounting principles (GAAP) and the schedules equivalent to the basic financial statements that are included in the IDI's appropriate regulatory report (for example, Schedules RC, RI, and RI-A in the Consolidated Reports of Condition and Income [Call Report]). Accordingly, to comply with FDICIA and Part 363, management of the IDI (or a parent holding company)[1] and the auditor should identify and test controls over the preparation of GAAP-based financial statements as well as the schedules equivalent to the basic financial statements that are included in the IDI's (or its holding company's) appropriate regulatory report. Further, both management and the auditor should include in their report on the IDI's (or its holding company's) internal control a specific description indicating that the scope of internal control included controls over the preparation of the IDI's (or its holding company's) GAAP-based financial statements as well as the schedules equivalent to the basic financial statements that are included in the IDI's (or its holding company's) appropriate regulatory report.

2. In accordance with paragraph .107 of this section, the auditor's report should include a definition of internal control (the auditor should use the same description of the entity's internal control as management uses in its report). The following is an illustrative definition paragraph that may be used when an IDI that is a 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 examination were conducted to meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), our examination 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

[1] See Financial Institution Letter (FIL) 86-94 for further discussion of reporting at the holding company level for Federal Deposit Insurance Corporation Improvement Act purposes and the application of holding company reporting as it relates to controls over the preparation of "regulatory reports."

Holding Companies (Form FR Y-9C).[2] An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

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[2] This sentence would be modified if the insured depository institution (IDI) reports at the institution level rather than at the bank holding company level to refer to the Federal Financial Institutions Examination Council Instructions for Consolidated Reports of Condition and Income or the Office of Thrift Supervision Instructions for Thrift Financial Reports 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 FIL 86-94.

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Exhibit D—Illustrative Management Report

1. The following is an illustrative management report containing the reporting elements described in paragraph .95 of this section:

Management's Report on Internal Control Over Financial Reporting

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

Management is responsible for establishing and maintaining effective internal control over financial reporting. Management assessed the effectiveness of W Company's internal control over financial reporting as of December 31, 20XX, based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control—Integrated Framework*. Based on that assessment, management concluded that, as of December 31, 20XX, W Company's internal control over financial reporting is effective based on the criteria established in *Internal Control—Integrated Framework*.

W Company

Report signers, if applicable

Date

AT Section 9501

An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements: Attest Engagements Interpretations of Section 501

1. Reporting Under Section 112 of the Federal Deposit Insurance Corporation Improvement Act

.01 *Question*—For purposes of compliance by insured depository institutions (IDIs) with Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) (Section 36, Independent Annual Audits of Insured Depository Institutions, of the Federal Deposit Insurance Act [*Banks and Banking*, *U.S. Code* Title 12, Section 1831m]) and its implementing regulation, Title 12 U.S. *Code of Federal Regulations* (CFR) Part 363, an IDI that is a subsidiary of a holding company may use the consolidated holding company's financial statements to satisfy the audited financial statements requirement of 12 CFR 363, provided certain criteria are met.[1] For some IDIs, however, an examination of internal control over financial reporting is required at the IDI level. Paragraph .18 of section 501, *An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements*, requires that an examination of internal control over financial reporting (internal control) be integrated with an audit of financial statements. For IDIs that require an examination of internal control at the IDI level, can the auditor meet the integrated audit requirement when the IDI does not prepare financial statements for external distribution? If so, how can the auditor report on the effectiveness of the IDI's internal control over financial reporting?

.02 *Interpretation*—To comply with the integrated audit requirement in section 501, when the IDI uses the consolidated holding company's financial statements to satisfy the audited financial statements requirement of 12 CFR 363, the auditor would be required to perform procedures necessary to obtain sufficient appropriate audit evidence to enable the auditor to express an opinion on the IDI's financial statements and on its internal control over financial reporting. When the IDI does not prepare financial statements for external distribution, "financial statements" for this purpose may consist of the IDI's financial information in a reporting package or equivalent schedules and analyses that include the IDI information necessary for the preparation of the holding company's consolidated financial statements, including disclosures. The measurement of materiality is determined based on the IDI's financial information rather than the consolidated holding company's financial statements.[2] If the

[1] Refer to Section 36 of the Federal Deposit Insurance Act (FDI Act), Section 363.1: Scope and Definitions, for the requirements pertaining to compliance by subsidiaries of holding companies.

[2] See paragraph .10 of AU-C section 320, *Materiality in Planning and Performing an Audit*. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

auditor is unable to apply the procedures necessary to obtain sufficient appropriate audit evidence with respect to the IDI's financial information, the auditor is required by paragraph .117 of section 501 to withdraw from the engagement or disclaim an opinion on the effectiveness of the IDI's internal control over financial reporting.

.03 As indicated in exhibit C, "Reporting Under Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA)," of section 501, the FDIC indicated that financial reporting, at a minimum, includes financial statements prepared in accordance with generally accepted accounting principles (GAAP) and the schedules equivalent to the basic financial statements that are included in the IDI's appropriate regulatory report (for example, Schedules RC, RI, and RI-A in the Consolidated Reports of Condition and Income [call report]). When the IDI does not prepare financial statements for external distribution, the auditor is, nevertheless, required by paragraph .41 of section 501 to evaluate the IDI's period-end financial reporting process. This process includes, among other things, the IDI's procedures for preparing financial information for purposes of the consolidated holding company's financial statements, which are prepared in accordance with GAAP, and the schedules equivalent to the basic financial statements that are included in the IDI's appropriate regulatory report.

.04 The period-end financial reporting process may occur either at the IDI or the holding company, or both. The organizational structure, including where the controls relevant to the IDI's financial information operate, may affect how the auditor evaluates this process. For example,

a. when the period-end financial reporting process occurs at the holding company and the IDI comprises substantially all of the consolidated total assets, there may be no distinguishable difference between the IDI's and its holding company's process for purposes of the integrated audit. This is because the auditor's risk assessment, including the determination of significant accounts and disclosures and relevant assertions, the selection of controls to test, and the determination of the evidence necessary to conclude on the effectiveness of a given control, would likely be the same for the IDI and the holding company.[3] In this circumstance, the period-end financial reporting process of the holding company would be, in effect, the period-end financial reporting process of the IDI and, therefore, would be included in the scope of the integrated audit of the IDI.

b. when the period-end financial reporting process occurs at the holding company and the IDI does not comprise substantially all of the consolidated total assets, the IDI's financial reporting process may be sufficient for the auditor to meet the requirement in paragraph .41 of section 501, if the necessary GAAP information is prepared by the IDI or the holding company, and the process can be evaluated by the auditor. The auditor may determine that the IDI's preparation of the IDI's appropriate regulatory report, together with other financial information at the IDI level that is incorporated into the consolidated holding company's financial statements, is sufficient for this purpose. In this circumstance, both the period-end financial reporting process of the holding company, as it relates to the financial information of the IDI, and the period-end financial reporting process of the IDI, with respect to the preparation of the schedules equivalent to the basic financial statements that are

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[3] See paragraph .23 of section 501, *An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements*.

included in the IDI's appropriate regulatory report, would be included in the scope of the integrated audit of the IDI.

.05 The illustrative reports in exhibit A, "Illustrative Reports," of section 501 may be used to report on the effectiveness of the IDI's internal control over financial reporting. Because 12 CFR 363 does not require the auditor to issue a separate auditor's report on the IDI's financial statements, the requirement in paragraph .109 of section 501 to add a paragraph to the internal control 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 .107 of section 501, the auditor's report on internal control is required to include a definition of *internal control* that uses the same description of internal control 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 elects to report on controls for FDICIA purposes at the IDI level, and the IDI uses the consolidated holding company's financial statements to satisfy the audited financial statements requirement of 12 CFR 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 examination were conducted to meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), our examination 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.

.06 Management may evaluate and report on the effectiveness of the IDI's internal control based on the Committee of Sponsoring Organizations of the Treadway Commission's (COSO) report, *Internal Control—Integrated Framework*. Because COSO establishes control objectives relating to the preparation of reliable "published" financial statements, the COSO criteria, as modified for purposes of reporting under Section 112 of FDICIA, is appropriate only for the IDI and its regulatory agencies. Accordingly, the report is required to be restricted as to use.[4] An example of such a restriction is as follows:

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[4] Paragraph .78 of section 101, *Attest Engagements*, requires the report to be restricted as to use "when the criteria used to evaluate the subject matter are determined by the practitioner to be appropriate only for a limited number of parties who either participated in their establishment or can

(continued)

This report is intended solely for the information and use of management, [*identify the body or individuals charged with governance*], others within the organization, the Federal Deposit Insurance Corporation and [*other federal bank regulatory agency*] and is not intended to be and should not be used by anyone other than these specified parties.

.07 Likewise, the auditor's report and management's assertion refer to the modified COSO criteria. For example, the following may be used to identify the criteria: "criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) as modified for the express purpose of meeting the regulatory requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA)."

[Issue Date: September 2010.]

(footnote continued)

be presumed to have an adequate understanding of the criteria." Although reports on internal control issued in accordance with this interpretation are required to be restricted as to use, Section 36 of the FDI Act and Title 12 U.S. *Code of Federal Regulations* Part 363 require that these reports be available for public inspection.

AT Section 601

Compliance Attestation

Source: SSAE No. 10.

Effective when the subject matter or assertion is as of or for a period ending on or after June 1, 2001. Earlier application is permitted.

Introduction and Applicability

.01 This section provides guidance for engagements related to either (*a*) an entity's compliance with requirements of specified laws, regulations, rules, contracts, or grants or (*b*) the effectiveness of an entity's internal control over compliance with specified requirements.[1] Compliance requirements may be either financial or nonfinancial in nature. An attest engagement conducted in accordance with this section should comply with the general, fieldwork, and reporting standards established in section 50, *SSAE Hierarchy*, and the specific standards set forth in this section. [Revised, November 2006, to reflect conforming changes necessary due to the issuance of SSAE No. 14.]

.02 This section does not—

a. Affect the auditor's responsibility in an audit of financial statements performed in accordance with generally accepted auditing standards (GAAS).

b. Apply to situations in which an auditor reports on specified compliance requirements based solely on an audit of financial statements, as addressed in AU-C section 806, *Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements*.

c. Apply to engagements for which the objective is to report in accordance with AU-C section 935, *Compliance Audits*, unless the terms of the engagement specify an attest report under this section.

d. Apply to engagements covered by AU-C section 920, *Letters for Underwriters and Certain Other Requesting Parties*.

e. Apply to the report that encompasses internal control over compliance for a broker or dealer in securities as required by rule 17a-5 of the Securities Exchange Act of 1934 (the 1934 Act).[2]

[Revised, December 2010, to reflect conforming changes necessary due to the issuance of SAS No. 117. Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

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[1] Throughout this section—

a. An entity's compliance with requirements of specified laws, regulations, rules, contracts, or grants is referred to as *compliance with specified requirements*.

b. An entity's internal control over compliance with specified requirements is referred to as its *internal control over compliance*. The internal control addressed in this section may include parts of but is not the same as internal control over financial reporting.

[2] An example of this report is contained in AICPA Audit and Accounting Guide *Brokers and Dealers in Securities*.

.03 A report issued in accordance with the provisions of this section does not provide a legal determination of an entity's compliance with specified requirements. However, such a report may be useful to legal counsel or others in making such determinations.

Scope of Services

.04 The practitioner may be engaged to perform agreed-upon procedures to assist users in evaluating the following subject matter (or assertions related thereto)—

a. The entity's compliance with specified requirements

b. The effectiveness of the entity's internal control over compliance[3]

c. Both the entity's compliance with specified requirements and the effectiveness of the entity's internal control over compliance

The practitioner also may be engaged to examine the entity's compliance with specified requirements or a written assertion thereon.

.05 An important consideration in determining the type of engagement to be performed is expectations by users of the practitioner's report. Since the users decide the procedures to be performed in an agreed-upon procedures engagement, it often will be in the best interests of the practitioner and users (including the client) to have an agreed-upon procedures engagement rather than an examination engagement. When deciding whether to accept an examination engagement, the practitioner should consider the risks discussed in paragraphs .31–.35.

.06 A practitioner may be engaged to examine the effectiveness of the entity's internal control over compliance or an assertion thereon. However, in accordance with section 50, the practitioner cannot accept an engagement unless he or she has reason to believe that the subject matter is capable of reasonably consistent evaluation against criteria that are suitable and available to users.[4] If a practitioner determines that such criteria do exist for internal

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[3] An entity's internal control over compliance is the process by which management obtains reasonable assurance of compliance with specified requirements. Although the comprehensive internal control may include a wide variety of objectives and related policies and procedures, only some of these may be relevant to an entity's compliance with specified requirements. (See footnote 1*b*.) The components of internal control over compliance vary based on the nature of the compliance requirements. For example, internal control over compliance with a capital requirement would generally include accounting procedures, whereas internal control over compliance with a requirement to practice nondiscriminatory hiring may not include accounting procedures.

[4] Criteria issued by regulatory agencies and other groups composed of experts that follow due-process procedures, including exposure of the proposed criteria for public comment, ordinarily should be considered suitable criteria for this purpose. For example, the Committee of Sponsoring Organizations (COSO) of the Treadway Commission's Report, *Internal Control—Integrated Framework*, provides suitable criteria against which management may evaluate and report on the effectiveness of the entity's internal control. However, more detailed criteria relative to specific compliance requirements may have to be developed and an appropriate threshold for measuring the severity of control deficiencies needs to be developed in order to apply the concepts of the COSO report to internal control over compliance.

Criteria established by a regulatory agency that does not follow such due-process procedures also may be considered suitable criteria for use by the regulatory agency. The practitioner should determine whether such criteria are suitable for general use reporting by evaluating them against the attributes in paragraph .24 of section 101. If the practitioner determines that such criteria are suitable for general use reporting, those criteria should also be available to users as discussed in paragraph .33 of section 101.

If the practitioner concludes that the criteria are appropriate only for a limited number of parties or are available only to specified parties, the practitioner's report shall state that the use of the report is restricted to those parties specified in the report. (See paragraphs .30, .34, and .78–.83 of section 101.)

control over compliance, he or she should perform the engagement in accordance with section 101, *Attest Engagements*. Additionally, section 501, *An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements*, may be helpful to a practitioner in such an engagement. [Revised, November 2006, to reflect conforming changes necessary due to the issuance of SSAE No. 14.]

.07 A practitioner should not accept an engagement to perform a review, as defined in paragraph .55 of section 101, of an entity's compliance with specified requirements or about the effectiveness of an entity's internal control over compliance or an assertion thereon.

.08 The practitioner may be engaged to provide other types of services in connection with the entity's compliance with specified requirements or the entity's internal control over compliance. For example, management may engage the practitioner to provide recommendations on how to improve the entity's compliance or related internal control. A practitioner engaged to provide such nonattest services should refer to the guidance in CS section 100, *Consulting Services: Definitions and Standards*.

Conditions for Engagement Performance

.09 A practitioner may perform an agreed-upon procedures engagement related to an entity's compliance with specified requirements or the effectiveness of internal control over compliance if the following conditions are met.

a. The responsible party accepts responsibility for the entity's compliance with specified requirements and the effectiveness of the entity's internal control over compliance.

b. The responsible party evaluates the entity's compliance with specified requirements or the effectiveness of the entity's internal control over compliance.

See also section 201, *Agreed-Upon Procedures Engagements*.

.10 A practitioner may perform an examination engagement related to an entity's compliance with specified requirements if the following conditions are met.

a. The responsible party accepts responsibility for the entity's compliance with specified requirements and the effectiveness of the entity's internal control over compliance.

b. The responsible party evaluates the entity's compliance with specified requirements.

c. Sufficient evidential matter exists or could be developed to support management's evaluation.

.11 As part of engagement performance, the practitioner should obtain from the responsible party a written assertion about compliance with specified requirements or internal control over compliance. The responsible party may present its written assertion in either of the following:

a. A separate report that will accompany the practitioner's report

b. A representation letter to the practitioner

.12 The responsible party's written assertion about compliance with specified requirements or internal control over compliance may take many forms. Throughout this section, for example, the phrase "responsible party's assertion that W Company complied with [*specify compliance requirement*] as of [*date*]," illustrates such an assertion. Other phrases may also be used. However, a practitioner should not accept an assertion that is so subjective (for example, "very effective" internal control over compliance) that people having competence in and using the same or similar criteria would not ordinarily be able to arrive at similar conclusions.

.13 Regardless of whether the practitioner's client is the responsible party, the responsible party's refusal to furnish a written assertion as part of an examination engagement should cause the practitioner to withdraw from the engagement. However, an exception is provided if an examination of an entity's compliance with specified requirements is required by law or regulation. In that instance, the practitioner should disclaim an opinion on compliance unless he or she obtains evidential matter that warrants expressing an adverse opinion. If the practitioner expresses an adverse opinion and the responsible party does not provide an assertion, the practitioner's report should be restricted as to use. (See paragraphs .78–.81 of section 101.) If, as part of an agreed-upon procedures engagement, the practitioner's client is the responsible party, a refusal by that party to provide an assertion requires the practitioner to withdraw from the engagement. However, withdrawal is not required if the engagement is required by law or regulation. If, in an agreed-upon procedures engagement, the practitioner's client is not the responsible party, the practitioner is not required to withdraw but should consider the effects of the responsible party's refusal on the engagement and his or her report.

.14 Additionally, at the beginning of the engagement, the practitioner may want to consider discussing with the client and the responsible party the need for the responsible party to provide the practitioner with a written representation letter at the conclusion of the examination engagement or an agreed-upon procedures engagement in which the client is the responsible party. In that letter, the responsible party will be asked to provide, among other possible items, an acknowledgment of their responsibility for establishing and maintaining effective internal control over compliance and their assertion stating their evaluation of the entity's compliance with specified requirements. The responsible party's refusal to furnish these representations (see paragraphs .68–.70) will constitute a limitation on the scope of the engagement.

Responsible Party

.15 The responsible party is responsible for ensuring that the entity complies with the requirements applicable to its activities. That responsibility encompasses the following.

a. Identify applicable compliance requirements.

b. Establish and maintain internal control to provide reasonable assurance that the entity complies with those requirements.

c. Evaluate and monitor the entity's compliance.

d. Specify reports that satisfy legal, regulatory, or contractual requirements.

The responsible party's evaluation may include documentation such as accounting or statistical data, entity policy manuals, accounting manuals, narrative memoranda, procedural write-ups, flowcharts, completed questionnaires, or internal auditors' reports. The form and extent of documentation will vary depending on the nature of the compliance requirements and the size and complexity of the entity. The responsible party may engage the practitioner to gather information to assist it in evaluating the entity's compliance. Regardless of the procedures performed by the practitioner, the responsible party must accept responsibility for its assertion and must not base such assertion solely on the practitioner's procedures.

Agreed-Upon Procedures Engagement

.16 The objective of the practitioner's agreed-upon procedures is to present specific findings to assist users in evaluating an entity's compliance with specified requirements or the effectiveness of an entity's internal control over compliance based on procedures agreed upon by the users of the report. A practitioner engaged to perform agreed-upon procedures on an entity's compliance with specified requirements or about the effectiveness of an entity's internal control over compliance should follow the guidance set forth herein and in section 201.

.17 The practitioner's procedures generally may be as limited or as extensive as the specified users desire, as long as the specified users (*a*) agree upon the procedures performed or to be performed and (*b*) take responsibility for the sufficiency of the agreed-upon procedures for their purposes. (See paragraph .15 of section 201.)

.18 To satisfy the requirements that the practitioner and the specified users agree upon the procedures performed or to be performed and that the specified users take responsibility for the sufficiency of the agreed-upon procedures for their purposes, ordinarily the practitioner should communicate directly with and obtain affirmative acknowledgment from each of the specified users. For example, this may be accomplished by meeting with the specified users or by distributing a draft of the anticipated report or a copy of an engagement letter to the specified users and obtaining their agreement. If the practitioner is not able to communicate directly with all of the specified users, the practitioner may satisfy these requirements by applying any one or more of the following or similar procedures.

- Compare the procedures to be applied to written requirements of the specified users.
- Discuss the procedures to be applied with appropriate representatives of the specified users involved.
- Review relevant contracts with or correspondence from the specified users.

The practitioner should not report on an engagement when specified users do not agree upon the procedures performed or to be performed and do not take responsibility for the sufficiency of the procedures for their purposes. See paragraph .36 of section 201 for guidance on satisfying these requirements when the practitioner is requested to add other parties as specified parties after the date of completion of the agreed-upon procedures.

.19 In an engagement to perform agreed-upon procedures on an entity's compliance with specified requirements or about the effectiveness of an entity's internal control over compliance, the practitioner is required to perform only the procedures that have been agreed to by users.[5] However, prior to performing such procedures, the practitioner should obtain an understanding of the specified compliance requirements, as discussed in paragraph .20. (See section 201.)

.20 To obtain an understanding of the specified compliance requirements, a practitioner should consider the following:

a. Laws, regulations, rules, contracts, and grants that pertain to the specified compliance requirements, including published requirements

b. Knowledge about the specified compliance requirements obtained through prior engagements and regulatory reports

c. Knowledge about the specified compliance requirements obtained through discussions with appropriate individuals within the entity (for example, the chief financial officer, internal auditors, legal counsel, compliance officer, or grant or contract administrators)

d. Knowledge about the specified compliance requirements obtained through discussions with appropriate individuals outside the entity (for example, a regulator or a third-party specialist)

.21 When circumstances impose restrictions on the scope of an agreed-upon procedures engagement, the practitioner should attempt to obtain agreement from the users for modification of the agreed-upon procedures. When such agreement cannot be obtained (for example, when the agreed-upon procedures are published by a regulatory agency that will not modify the procedures), the practitioner should describe such restrictions in his or her report or withdraw from the engagement.

.22 The practitioner has no obligation to perform procedures beyond the agreed-upon procedures. However, if noncompliance comes to the practitioner's attention by other means, such information ordinarily should be included in his or her report.

.23 The practitioner may become aware of noncompliance that occurs subsequent to the period addressed by the practitioner's report but before the date of the practitioner's report. The practitioner should consider including information regarding such noncompliance in his or her report. However, the practitioner has no responsibility to perform procedures to detect such noncompliance other than obtaining the responsible party's representation about noncompliance in the subsequent period, as described in paragraph .68.

.24 The practitioner's report on agreed-upon procedures on an entity's compliance with specified requirements (or the effectiveness of an entity's internal control over compliance) should be in the form of procedures and findings. The practitioner's report should contain the following elements:

a. A title that includes the word *independent*

b. Identification of the specified parties

c. Identification of the subject matter of the engagement (or management's assertion thereon), including the period or point in time addressed and a reference to the character of the engagement[6]

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[5] AU-C section 610, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*, does not apply to agreed-upon procedures engagements. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

[6] Generally, management's assertion about compliance with specified requirements will address a *period* of time, whereas an assertion about internal control over compliance will address a *point* in time.

d. An identification of the responsible party

e. A statement that the subject matter is the responsibility of the responsible party

f. A statement that the procedures, which were agreed to by the specified parties identified in the report, were performed to assist the specified parties in evaluating the entity's compliance with specified requirements or the effectiveness of its internal control over compliance

g. A statement that the agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants

h. A statement that the sufficiency of the procedures is solely the responsibility of the specified parties and a disclaimer of responsibility for the sufficiency of those procedures

i. A list of the procedures performed (or reference thereto) and related findings (The practitioner should not provide negative assurance. See paragraph .24 of section 201.)

j. Where applicable, a description of any agreed-upon materiality limits (See paragraph .25 of section 201.)

k. A statement that the practitioner was not engaged to and did not conduct an examination of the entity's compliance with specified requirements (or the effectiveness of an entity's internal control over compliance), a disclaimer of opinion thereon, and a statement that if the practitioner had performed additional procedures, other matters might have come to his or her attention that would have been reported

l. A statement restricting the use of the report to the specified parties

m. Where applicable, reservations or restrictions concerning procedures or findings as discussed in paragraphs .33, .35, and .39–.40 of section 201

n. Where applicable, a description of the nature of the assistance provided by the specialist as discussed in paragraphs .19–.21 of section 201

o. The manual or printed signature of the practitioner's firm

p. The date of the report

.25 The following is an illustration of an agreed-upon procedures report on an entity's compliance with specified requirements in which the procedures and findings are enumerated rather than referenced.

Independent Accountant's Report on Applying Agreed-Upon Procedures

We have performed the procedures enumerated below, which were agreed to by [*list specified parties*], solely to assist the specified parties in evaluating [*name of entity*]'s compliance with [*list specified requirements*] during the [*period*] ended [*date*].[7] Management is responsible for [*name of entity*]'s compliance with those requirements. This agreed-upon procedures engagement

[7] If the agreed-upon procedures have been published by a third-party user (for example, a regulator in regulatory policies or a lender in a debt agreement), this sentence might begin, "We have performed the procedures included in [*title of publication or other document*] and enumerated below, which were agreed to by [*list specified parties*], solely to assist the specified parties in evaluating ...."

was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

[*Include paragraphs to enumerate procedures and findings.*]

We were not engaged to and did not conduct an examination, the objective of which would be the expression of an opinion on compliance. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of [*list or refer to specified parties*] and is not intended to be and should not be used by anyone other than these specified parties.

[*Signature*]

[*Date*]

.26 Evaluating compliance with certain requirements may require interpretation of the laws, regulations, rules, contracts, or grants that establish those requirements. In such situations, the practitioner should consider whether he or she is provided with the suitable criteria required to evaluate an assertion under the third general attestation standard. If these interpretations are significant, the practitioner may include a paragraph stating the description and the source of interpretations made by the entity's management. An example of such a paragraph, which should precede the procedures and findings paragraph(s), follows.

We have been informed that, under [*name of entity*]'s interpretation of [*identify the compliance requirement*], [*explain the nature and source of the relevant interpretation*].

.27 The following is an illustration of an agreed-upon procedures report on the effectiveness of an entity's internal control over compliance in which the procedures and findings are enumerated rather than referenced.

<u>Independent Accountant's Report on Applying Agreed-Upon Procedures</u>

We have performed the procedures enumerated below, which were agreed to by [*list specified parties*], solely to assist the specified parties in evaluating the effectiveness of [*name of entity*]'s internal control over compliance with [*list specified requirements*] as of [*date*].[8] Management is responsible for [*name of entity*]'s internal control over compliance with those requirements. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

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[8] If the agreed-upon procedures have been published by a third-party user (for example, a regulator in regulatory policies or a lender in a debt agreement), this sentence might begin, "We have performed the procedures included in [*title of publication or other document*] and enumerated below, which were agreed to by [*list specified parties*], solely to assist the specified parties in evaluating the effectiveness of [*name of entity*]'s internal control over compliance ...."

[*Include paragraphs to enumerate procedures and findings.*]

We were not engaged to and did not conduct an examination, the objective of which would be the expression of an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of [*list or refer to specified parties*] and is not intended to be and should not be used by anyone other than these specified parties.

[*Signature*]

[*Date*]

.28 In some agreed-upon procedures engagements, procedures may relate to both compliance with specified requirements and the effectiveness of internal control over compliance. In these engagements, the practitioner may issue one report that addresses both. For example, the first sentence of the introductory paragraph would state the following.

We have performed the procedures enumerated below, which were agreed to by [*list users of report*], solely to assist the users in evaluating [*name of entity*]'s compliance with [*list specified requirements*] during the [*period*] ended [*date*] and the effectiveness of [*name of entity*]'s internal control over compliance with the aforementioned compliance requirements as of [*date*].

.29 The date of completion of the agreed-upon procedures should be used as the date of the practitioner's report.

Examination Engagement

.30 The objective of the practitioner's examination procedures applied to an entity's compliance with specified requirements is to express an opinion on an entity's compliance (or assertion related thereto), based on the specified criteria. To express such an opinion, the practitioner accumulates sufficient evidence about the entity's compliance with specified requirements, thereby restricting attestation risk to an appropriately low level.

Attestation Risk

.31 In an engagement to examine compliance with specified requirements, the practitioner seeks to obtain reasonable assurance that the entity complied, in all material respects, based on the specified criteria. This includes designing the examination to detect both intentional and unintentional material noncompliance. Absolute assurance is not attainable because of factors such as the need for judgment, the use of sampling, and the inherent limitations of internal control over compliance and because much of the evidence available to the practitioner is persuasive rather than conclusive in nature. Also, procedures that are effective for detecting noncompliance that is unintentional may be ineffective for detecting noncompliance that is intentional and concealed through collusion between personnel of the entity and a third party or among management or employees of the entity. Therefore, the subsequent discovery that material noncompliance exists does not, in and of itself, evidence inadequate planning, performance, or judgment on the part of the practitioner.

.32 Attestation risk is the risk that the practitioner may unknowingly fail to modify appropriately his or her opinion. It is composed of inherent risk, control risk, and detection risk. For purposes of a compliance examination, these components are defined as follows:

a. *Inherent risk*—The risk that material noncompliance with specified requirements could occur, assuming there are no related controls

b. *Control risk*—The risk that material noncompliance that could occur will not be prevented or detected on a timely basis by the entity's controls

c. *Detection risk*—The risk that the practitioner's procedures will lead him or her to conclude that material noncompliance does not exist when, in fact, such noncompliance does exist

Inherent Risk

.33 In assessing inherent risk, the practitioner should consider factors affecting risk similar to those an auditor would consider when planning an audit of financial statements. Such factors are discussed in paragraph .A75 of AU-C section 240, *Consideration of Fraud in a Financial Statement Audit*. In addition, the practitioner should consider factors relevant to compliance engagements, such as the following:

- The complexity of the specified compliance requirements
- The length of time the entity has been subject to the specified compliance requirements
- Prior experience with the entity's compliance
- The potential impact of noncompliance

[Revised, January 2004, to reflect conforming changes necessary due to the issuance of SAS No. 99. Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Control Risk

.34 The practitioner should assess control risk as discussed in paragraphs .45–.46. Assessing control risk contributes to the practitioner's evaluation of the risk that material noncompliance exists. The process of assessing control risk (together with assessing inherent risk) provides evidential matter about the risk that such noncompliance may exist. The practitioner uses this evidential matter as part of the reasonable basis for his or her opinion.

Detection Risk

.35 In determining an acceptable level of detection risk, the practitioner assesses inherent risk and control risk and considers the extent to which he or she seeks to restrict attestation risk. As assessed inherent risk or control risk decreases, the acceptable level of detection risk increases. Accordingly, the practitioner may alter the nature, timing, and extent of compliance tests performed based on the assessments of inherent risk and control risk.

Materiality

.36 In an examination of an entity's compliance with specified requirements, the practitioner's consideration of materiality differs from that of an audit of financial statements in accordance with GAAS. In an examination of an entity's compliance with specified requirements, the practitioner's consideration of materiality is affected by (*a*) the nature of the compliance requirements, which may or may not be quantifiable in monetary terms, (*b*) the nature and frequency of noncompliance identified with appropriate consideration of sampling risk, and (*c*) qualitative considerations, including the needs and expectations of the report's users.

.37 In a number of situations, the terms of the engagement may provide for a supplemental report of all or certain noncompliance discovered. Such terms should not change the practitioner's judgments about materiality in planning and performing the engagement or in forming an opinion on an entity's compliance with specified requirements or on the responsible party's assertion about such compliance.

Performing an Examination Engagement

.38 The practitioner should exercise (*a*) due care in planning, performing, and evaluating the results of his or her examination procedures and (*b*) the proper degree of professional skepticism to achieve reasonable assurance that material noncompliance will be detected.

.39 In an examination of the entity's compliance with specified requirements, the practitioner should—

a. Obtain an understanding of the specified compliance requirements. (See paragraph .40.)

b. Plan the engagement. (See paragraphs .41–.44.)

c. Consider relevant portions of the entity's internal control over compliance. (See paragraphs .45–.47.)

d. Obtain sufficient evidence including testing compliance with specified requirements. (See paragraphs .48–.49.)

e. Consider subsequent events. (See paragraphs .50–.52.)

f. Form an opinion about whether the entity complied, in all material respects, with specified requirements (or whether the responsible party's assertion about such compliance is fairly stated in all material respects), based on the specified criteria. (See paragraph .53.)

Obtaining an Understanding of the Specified Compliance Requirements

.40 A practitioner should obtain an understanding of the specified compliance requirements. To obtain such an understanding, a practitioner should consider the following:

a. Laws, regulations, rules, contracts, and grants that pertain to the specified compliance requirements, including published requirements

b. Knowledge about the specified compliance requirements obtained through prior engagements and regulatory reports

c. Knowledge about the specified compliance requirements obtained through discussions with appropriate individuals within the entity (for example, the chief financial officer, internal auditors, legal counsel, compliance officer, or grant or contract administrators)

d. Knowledge about the specified compliance requirements obtained through discussions with appropriate individuals outside the entity (for example, a regulator or third-party specialist)

Planning the Engagement

General Considerations

.41 Planning an engagement to examine an entity's compliance with specified requirements involves developing an overall strategy for the expected conduct and scope of the engagement. The practitioner should consider the planning matters discussed in paragraphs .42–.47 of section 101.

Multiple Components

.42 In an engagement to examine an entity's compliance with specified requirements when the entity has operations in several components (for example, locations, branches, subsidiaries, or programs), the practitioner may determine that it is not necessary to test compliance with requirements at every component. In making such a determination and in selecting the components to be tested, the practitioner should consider factors such as the following:

- *a.* The degree to which the specified compliance requirements apply at the component level
- *b.* Judgments about materiality
- *c.* The degree of centralization of records
- *d.* The effectiveness of the control environment, particularly management's direct control over the exercise of authority delegated to others and its ability to supervise activities at various locations effectively
- *e.* The nature and extent of operations conducted at the various components
- *f.* The similarity of operations over compliance for different components

Using the Work of a Specialist

.43 In some compliance engagements, the nature of the specified compliance requirements may require specialized skill or knowledge in a particular field other than accounting or auditing. In such cases, the practitioner may use the work of a specialist and should follow the relevant performance and reporting guidance in AU-C section 620, *Using the Work of an Auditor's Specialist*. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Internal Audit Function

.44 Another factor the practitioner should consider when planning the engagement is whether the entity has an internal audit function and the extent to which internal auditors are involved in monitoring compliance with the specified requirements. A practitioner should consider the guidance in AU-C section 610, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*, when addressing the competence and objectivity of internal auditors, the nature, timing, and extent of work to be performed, and other related matters. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Consideration of Internal Control Over Compliance

.45 The practitioner should obtain an understanding of relevant portions of internal control over compliance sufficient to plan the engagement and to assess control risk for compliance with specified requirements. In planning the examination, such knowledge should be used to identify types of potential noncompliance, to consider factors that affect the risk of material noncompliance, and to design appropriate tests of compliance.

.46 A practitioner generally obtains an understanding of the design of specific controls by performing the following:

a. Inquiries of appropriate management, supervisory, and staff personnel

b. Inspection of the entity's documents

c. Observation of the entity's activities and operations

The nature and extent of procedures a practitioner performs vary from entity to entity and are influenced by factors such as the following:

- The newness and complexity of the specified requirements
- The practitioner's knowledge of internal control over compliance obtained in previous professional engagements
- The nature of the specified compliance requirements
- An understanding of the industry in which the entity operates
- Judgments about materiality

When seeking to assess control risk below the maximum, the practitioner should perform tests of controls to obtain evidence to support the assessed level of control risk.

.47 During the course of an examination engagement, the practitioner may become aware of significant deficiencies or material weaknesses in the design or operation of internal control over compliance that could adversely affect the entity's ability to comply with specified requirements. A practitioner's responsibility to communicate these deficiencies in an examination of an entity's compliance with specified requirements is similar to the auditor's responsibility described in AU-C section 265, *Communicating Internal Control Related Matters Identified in an Audit*. If, in a multiple-party arrangement, the practitioner's client is not the responsible party, the practitioner has no responsibility to communicate significant deficiencies or material weaknesses to the responsible party. For example, if the practitioner is engaged by his or her client to examine the compliance of another entity, the practitioner has no obligation to communicate any significant deficiencies or material weaknesses that he or she becomes aware of to the other entity. However, the practitioner is not precluded from making such a communication. [Revised, May 2006, to reflect conforming changes necessary due to the issuance of SAS No. 112. Revised, January 2010, to reflect conforming changes necessary due to the issuance of SAS No. 115. Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Obtaining Sufficient Evidence

.48 The practitioner should apply procedures to provide reasonable assurance of detecting material noncompliance. Determining these procedures and evaluating the sufficiency of the evidence obtained are matters of professional judgment. When exercising such judgment, practitioners should consider the guidance contained in paragraphs .51–.54 of section 101 and AU-C section 530, *Audit Sampling*. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.49 For engagements involving compliance with regulatory requirements, the practitioner's procedures should include reviewing reports of significant examinations and related communications between regulatory agencies and the entity and, when appropriate, making inquiries of the regulatory agencies, including inquiries about examinations in progress.

Consideration of Subsequent Events

.50 The practitioner's consideration of subsequent events in an examination of an entity's compliance with specified requirements is similar to the auditor's consideration of subsequent events in a financial statement audit, as outlined in AU-C section 560, *Subsequent Events and Subsequently Discovered Facts*. The practitioner should consider information about such events that comes to his or her attention after the end of the period addressed by the practitioner's report and prior to the issuance of his or her report. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.51 Two types of subsequent events require consideration by the responsible party and evaluation by the practitioner. The first consists of events that provide additional information about the entity's compliance during the period addressed by the practitioner's report and may affect the practitioner's report. For the period from the end of the reporting period (or point in time) to the date of the practitioner's report, the practitioner should perform procedures to identify such events that provide additional information about compliance during the reporting period. Such procedures should include but may not be limited to inquiring about and considering the following information:

- Relevant internal auditors' reports issued during the subsequent period
- Other practitioners' reports identifying noncompliance, issued during the subsequent period
- Regulatory agencies' reports on the entity's noncompliance, issued during the subsequent period
- Information about the entity's noncompliance, obtained through other professional engagements for that entity

.52 The second type consists of noncompliance that occurs subsequent to the period being reported on but before the date of the practitioner's report. The practitioner has no responsibility to detect such noncompliance. However, should the practitioner become aware of such noncompliance, it may be of such a nature and significance that disclosure of it is required to keep users from being misled. In such cases, the practitioner should include in his or her report an explanatory paragraph describing the nature of the noncompliance.

Forming an Opinion

.53 In evaluating whether the entity has complied in all material respects (or whether the responsible party's assertion about such compliance is stated fairly in all material respects), the practitioner should consider (*a*) the nature and frequency of the noncompliance identified and (*b*) whether such noncompliance is material relative to the nature of the compliance requirements, as discussed in paragraph .36.

Reporting

.54 The practitioner may examine and report directly on an entity's compliance (see paragraphs .55–56) or he or she may examine and report on the responsible party's written assertion (see paragraphs .57–.58 and .61), except as described in paragraph .64.

.55 The practitioner's examination report on compliance, which is ordinarily addressed to the entity, should include the following:

a. A title that includes the word *independent*

b. Identification of the specified compliance requirements, including the period covered, and of the responsible party[9]

c. A statement that compliance with the specified requirements is the responsibility of the entity's management

d. A statement that the practitioner's responsibility is to express an opinion on the entity's compliance with those requirements based on his or her examination

e. A statement that the examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence about the entity's compliance with those requirements and performing such other procedures as the practitioner considered necessary in the circumstances

f. A statement that the practitioner believes the examination provides a reasonable basis for his or her opinion

g. A statement that the examination does not provide a legal determination on the entity's compliance

h. The practitioner's opinion on whether the entity complied, in all material respects, with specified requirements based on the specified criteria[10] (See paragraph .64 for reporting on material noncompliance.)

i. A statement restricting the use of the report to the specified parties (see the fourth reporting standard)[11] under the following circumstances (See also paragraph .13.):

- When the criteria used to evaluate compliance are determined by the practitioner to be appropriate only for a limited number of parties who either participated in their establishment or can be presumed to have an adequate understanding of the criteria.

- When the criteria used to evaluate compliance are available only to the specified parties

j. The manual or printed signature of the practitioner's firm

k. The date of the examination report

.56 The following is the form of report a practitioner should use when he or she is expressing an opinion on an entity's compliance with specified requirements during a period of time.

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[9] A practitioner also may be engaged to report on an entity's compliance with specified requirements as of point in time. In this case, the illustrative reports in this section should be adapted as appropriate.

[10] Frequently, criteria will be contained in the compliance requirements, in which case it is not necessary to repeat the criteria in the practitioner's report; however, if the criteria are not included in the compliance requirement, the practitioner's report should identify the criteria. For example, if a compliance requirement is to "maintain $25,000 in capital," it would not be necessary to identify the $25,000 in the report; however, if the requirement is to "maintain adequate capital," the practitioner should identify the criteria used to define *adequate*.

[11] In certain situations, however, criteria that have been specified by management and other report users may be suitable for general use.

<u>Independent Accountant's Report</u>

[*Introductory paragraph*]

We have examined [*name of entity*]'s compliance with [*list specified compliance requirements*] during the [*period*] ended [*date*]. Management is responsible for [*name of entity*]'s compliance with those requirements. Our responsibility is to express an opinion on [*name of entity*]'s compliance based on our examination.

[*Scope paragraph*]

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence about [*name of entity*]'s compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. Our examination does not provide a legal determination on [*name of entity*]'s compliance with specified requirements.

[*Opinion paragraph*]

In our opinion, [*name of entity*] complied, in all material respects, with the aforementioned requirements for the year ended December 31, 20XX.[12]

[*Signature*]

[*Date*]

.57 The practitioner's examination report on an entity's assertion about compliance with specified requirements, which is ordinarily addressed to the entity, should include the following:

a. A title that includes the word *independent*

b. Identification of the responsible party's assertion about the entity's compliance with specified requirements, including the period covered by the responsible party's assertion, and of the responsible party (When the responsible party's assertion does not accompany the practitioner's report, the first paragraph of the report should also contain a statement of the responsible party's assertion.)[13]

c. A statement that compliance with the requirements is the responsibility of the entity's management

d. A statement that the practitioner's responsibility is to express an opinion on the responsible party's assertion on the entity's compliance with those requirements based on his or her examination

e. A statement that the examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence about the entity's compliance with those requirements and performing such other procedures as the practitioner considered necessary in the circumstances

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[12] If it is necessary to identify criteria (see footnote 10), the criteria should be identified in the opinion paragraph (for example, "... in all material respects, based on the criteria set forth in Attachment 1").

[13] A practitioner also may be engaged to report on the responsible party's assertion about an entity's compliance with specified requirements as of a point in time. In this case, the illustrative reports in this section should be adapted as appropriate.

f. A statement that the practitioner believes the examination provides a reasonable basis for his or her opinion

g. A statement that the examination does not provide a legal determination on the entity's compliance

h. The practitioner's opinion on whether the responsible party's assertion about compliance with specified requirements is fairly stated in all material respects based on the specified criteria[14] (See paragraph .64 for reporting on material noncompliance.)

i. A statement restricting the use of the report to the specified parties (see the fourth reporting standard)[15,16] under the following circumstances:

- When the criteria used to evaluate compliance are determined by the practitioner to be appropriate only for a limited number of parties who either participated in their establishment or can be presumed to have an adequate understanding of the criteria
- When the criteria used to evaluate compliance are available only to the specified parties

j. The manual or printed signature of the practitioner's firm

k. The date of the examination report

.58 The following is the form of report that a practitioner should use when expressing an opinion on management's assertion about compliance with specified requirements.

Independent Accountant's Report

[*Introductory paragraph*]

We have examined management's assertion, included in the accompanying [*title of management report*], that [*name of entity*] complied with [*list specified compliance requirements*] during the [*period*] ended [*date*].[17,18] Management is responsible for [*name of entity*]'s compliance with those requirements. Our responsibility is to express an opinion on management's assertion about [*name of entity*]'s compliance based on our examination.

[*Standard scope paragraph*]

[*Opinion paragraph*]

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[14] Frequently, criteria will be contained in the compliance requirements, in which case it is not necessary to repeat the criteria in the practitioner's report; however, if the criteria are not included in the compliance requirement, the practitioner's report should identify the criteria. For example, if a compliance requirement is to "maintain $25,000 in capital," it would not be necessary to identify the $25,000 in the report; however, if the requirement is to "maintain adequate capital," the practitioner should identify the criteria used to define *adequate.*

[15] Although a practitioner's report may be appropriate for general use, the practitioner is not precluded from restricting the use of the report.

[16] In certain situations, however, criteria that have been specified by management and other report users may be suitable for general use.

[17] The practitioner should identify the management report examined by reference to the report title used by management in its report. Further, he or she should use the same description of compliance requirements as management uses in its report.

[18] If management's assertion is stated in the practitioner's report and does not accompany the practitioner's report, the phrase "included in the accompanying [*title of management report*]" would be omitted.

In our opinion, management's assertion that [*name of entity*] complied with the aforementioned requirements during the [*period*] ended [*date*] is fairly stated, in all material respects.[19]

[*Signature*]

[*Date*]

.59 Evaluating compliance with certain requirements may require interpretation of the laws, regulations, rules, contracts, or grants that establish those requirements. In such situations, the practitioner should consider whether he or she is provided with the suitable criteria required to evaluate compliance under the third general attestation standard. If these interpretations are significant, the practitioner may include a paragraph stating the description and the source of interpretations made by the entity's management. The following is an example of such a paragraph, which should directly follow the scope paragraph:

We have been informed that, under [*name of entity*]'s interpretation of [*identify the compliance requirement*], [*explain the source and nature of the relevant interpretation*].

.60 The date of completion of the examination procedures should be used as the date of the practitioner's report.

.61 Nothing precludes the practitioner from examining an assertion but opining directly on compliance.

.62 Paragraphs .78–.83 of section 101 provide guidance on restricting the use of an attest report. Nothing in this section precludes the practitioner from restricting the use of the report. For example, if the practitioner is asked by a client to examine another entity's compliance with certain regulations, he or she may want to restrict the use of the report to the client since the practitioner has no control over how the report may be used by the other entity.

Report Modifications

.63 The practitioner should modify the standard report described in paragraphs .55 and .57, if any of the following conditions exist.

- There is material noncompliance with specified requirements (paragraphs .64–.67).
- There is a restriction on the scope of the engagement.[20]
- The practitioner decides to refer to the report of another practitioner as the basis, in part, for the practitioner's report.[21]

Material Noncompliance

.64 When an examination of an entity's compliance with specified requirements discloses noncompliance with the applicable requirements that the practitioner believes have a material effect on the entity's compliance, the practitioner should modify the report and, to most effectively communicate with the reader of the report, should state his or her opinion on the entity's specified compliance requirements, not on the responsible party's assertion.

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[19] If it is necessary to identify criteria (see footnote 10), the criteria should be identified in the opinion paragraph (for example, "...in all material respects, based on the criteria set forth in Attachment 1").

[20] The practitioner should refer to paragraphs .73–.74 of section 101 for guidance on scope restrictions.

[21] The practitioner should refer to paragraphs .122–.125 of section 501 for guidance on an opinion based in part on the report of another practitioner and adapt such guidance to the standard reports in this section.

.65 The following is the form of report, modified with explanatory language, that a practitioner should use when he or she has concluded that a qualified opinion is appropriate under the circumstances. It has been assumed that the practitioner has determined that the specified compliance requirements are both suitable for general use and available to users as discussed in paragraphs .23–.33 of section 101, and, therefore, that a restricted use paragraph is not required.

<u>Independent Accountant's Report</u>

[*Introductory paragraph*]

We have examined [*name of entity*]'s compliance with [*list specified compliance requirements*] for the [*period*] ended [*date*]. Management is responsible for compliance with those requirements. Our responsibility is to express an opinion on [*name of entity*]'s compliance based on our examination.

[*Standard scope paragraph*]

[*Explanatory paragraph*]

Our examination disclosed the following material noncompliance with [*type of compliance requirement*] applicable to [*name of entity*] during the [*period*] ended [*date*]. [*Describe noncompliance.*]

[*Opinion paragraph*]

In our opinion, except for the material noncompliance described in the third paragraph, [*name of entity*] complied, in all material respects, with the aforementioned requirements for the [*period*] ended [*date*].

[*Signature*]

[*Date*]

.66 The following is the form of report, modified with explanatory language, that a practitioner should use when he or she concludes that an adverse opinion is appropriate in the circumstances. The practitioner has determined that the specified compliance requirements are both suitable for general use and available to users as discussed in paragraphs .23–.33 of section 101.

<u>Independent Accountant's Report</u>

[*Introductory paragraph*]

We have examined [*name of entity*]'s compliance with [*list specified compliance requirements*] for the [*period*] ended [*date*]. Management is responsible for compliance with those requirements. Our responsibility is to express an opinion on [*name of entity*]'s compliance based on our examination.

[*Standard scope paragraph*]

[*Explanatory paragraph*]

Our examination disclosed the following material noncompliance with [*type of compliance requirement*] applicable to [*name of entity*] during the [*period*] ended [*date*]. [*Describe noncompliance.*]

[*Opinion paragraph*]

In our opinion, because of the effect of the noncompliance described in the third paragraph, [*name of entity*] has not complied with the aforementioned requirements for the [*period*] ended [*date*].

[*Signature*]

[*Date*]

.67 If the practitioner's report on his or her examination of the entity's compliance with specified requirements is included in a document that also includes his or her audit report on the entity's financial statements, the following sentence should be included in the paragraph of an examination report that describes material noncompliance.

> These conditions were considered in determining the nature, timing, and extent of audit tests applied in our audit of the 20XX financial statements, and this report does not affect our report dated [*date of report*] on those financial statements.

The practitioner also may include the preceding sentence when the two reports are not included within the same document.

Representation Letter

.68 In an examination engagement or an agreed-upon procedures engagement, the practitioner should obtain written representations from the responsible party—[22]

a. Acknowledging the responsible party's responsibility for complying with the specified requirements.

b. Acknowledging the responsible party's responsibility for establishing and maintaining effective internal control over compliance.

c. Stating that the responsible party has performed an evaluation of (1) the entity's compliance with specified requirements or (2) the entity's controls for ensuring compliance and detecting noncompliance with requirements, as applicable.

d. Stating the responsible party's assertion about the entity's compliance with the specified requirements or about the effectiveness of internal control over compliance, as applicable, based on the stated or established criteria.

e. Stating that the responsible party has disclosed to the practitioner all known noncompliance.

f. State that the responsible party has made available all documentation related to compliance with the specified requirements.

g. Stating the responsible party's interpretation of any compliance requirements that have varying interpretations.

h. State that the responsible party has disclosed any communications from regulatory agencies, internal auditors, and other practitioners concerning possible noncompliance with the specified requirements, including communications received between the end of the period addressed in the written assertion and the date of the practitioner's report.

i. Stating that the responsible party has disclosed any known noncompliance occurring subsequent to the period for which, or date as of which, the responsible party selects to make its assertion.

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[22] Paragraph .21 of AU-C section 580, *Written Representations*, states that the written representations should be in the form of a representation letter addressed to the auditor. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.69 The responsible party's refusal to furnish all appropriate written representations in an examination engagement constitutes a limitation on the scope of the engagement sufficient to preclude an unqualified opinion and is ordinarily sufficient to cause the practitioner to disclaim an opinion or withdraw from the engagement. However, based on the nature of the representations not obtained or the circumstances of the refusal, the practitioner may conclude in an examination engagement that a qualified opinion is appropriate. When the practitioner is performing agreed-upon procedures and the practitioner's client is the responsible party, the responsible party's refusal to furnish all appropriate written representations constitutes a limitation on the scope of the engagement sufficient to cause the practitioner to withdraw. When the practitioner's client is not the responsible party, the practitioner is not required to withdraw but should consider the effects of the responsible party's refusal on his or her report. Further, the practitioner should consider the effects of the responsible party's refusal on his or her ability to rely on other representations of the responsible party.

.70 When the practitioner's client is not the responsible party, the practitioner may also want to obtain written representations from the client. For example, when a practitioner's client has entered into a contract with a third party (responsible party) and the practitioner is engaged to examine the responsible party's compliance with that contract, the practitioner may want to obtain written representations from his or her client as to their knowledge of any noncompliance.

Other Information in a Client-Prepared Document Containing Management's Assertion About the Entity's Compliance With Specified Requirements or the Effectiveness of the Internal Control Over Compliance

.71 An entity may publish various documents that contain information (referred to as *other information*) in addition to the practitioner's attest report on either (*a*) the entity's compliance with specified requirements or (*b*) the effectiveness of the entity's internal control over compliance or written assertion thereon. Paragraphs .91–.94 of section 101 provide guidance to the practitioner if the other information is contained in either of the following:

a. Annual reports to holders of securities or beneficial interests, annual reports of organizations for charitable or philanthropic purposes distributed to the public, and annual reports filed with regulatory authorities under the 1934 Act

b. Other documents to which the practitioner, at the client's request, devotes attention

Effective Date

.72 This section is effective when the subject matter or assertion is as of or for a period ending on or after June 1, 2001. Early application is permitted.

AT Section 701

Management's Discussion and Analysis

Source: SSAE No. 10.

Effective when management's discussion and analysis is for a period ending on or after June 1, 2001. Earlier application is permitted.

General

.01 This section sets forth attestation standards and provides guidance to a practitioner concerning the performance of an attest engagement[1] with respect to management's discussion and analysis (MD&A) prepared pursuant to the rules and regulations adopted by the Securities and Exchange Commission (SEC), which are presented in annual reports to shareholders and in other documents.[2]

Applicability

.02 This section is applicable to the following levels of service when a practitioner is engaged by (*a*) a public[3] entity that prepares MD&A in accordance with the rules and regulations adopted by the SEC (see paragraph .04) or (*b*) a nonpublic entity that prepares an MD&A presentation and whose management provides a written assertion that the presentation has been prepared using the rules and regulations adopted by the SEC:[4]

- An examination of an MD&A presentation
- A review of an MD&A presentation for an annual period, an interim period, or a combined annual and interim period[5]

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[1] Paragraph .01 of section 101, *Attest Engagements*, defines an attest engagement as one in which a practitioner "is engaged to issue or does issue an examination, a review, or an agreed-upon procedures report on subject matter, or an assertion about the subject matter (hereafter referred to as the *assertion*), that is the responsibility of another party."

[2] Because this section provides guidance specific to attest engagements concerning MD&A presentations, a practitioner should not perform a compliance attestation engagement under section 601, *Compliance Attestation*, with respect to an MD&A presentation.

[3] For purposes of this section, a public entity is any entity (*a*) whose securities trade in a public market either on a stock exchange (domestic or foreign) or in the over-the-counter (OTC) market, including securities quoted only locally or regionally, (*b*) that makes a filing with a regulatory agency in preparation for the sale of any class of its securities in a public market, or (*c*) a subsidiary, corporate joint venture, or other entity controlled by an entity covered by (*a*) or (*b*).

[4] Such assertion may be made by any of the following:
(*a*) Including a statement in the body of the MD&A presentation that it has been prepared using the rules and regulations adopted by the SEC.
(*b*) Providing a separate written assertion to accompany the MD&A presentation.
(*c*) Providing a written assertion in a representation letter to the practitioner.

[5] As discussed in paragraph .85*k*, a review report is not intended to be filed with the SEC as a report under the Securities Act of 1933 (the 1993 Act) or the Securities Exchange Act of 1934 (the 1934 Act) and, accordingly, the review report should contain a statement of restrictions on the use of the report to specified parties if the entity is (*a*) a public entity or (*b*) a nonpublic entity that is making or has made an offering of securities and it appears that the securities may subsequently be registered or subject to a filing with the SEC or other regulatory agency.

A practitioner[6] engaged to examine or review MD&A and report thereon should comply with the general, fieldwork, and reporting standards established in section 50, *SSAE Hierarchy*, and the specific standards set forth in this section. A practitioner engaged to perform agreed-upon procedures on MD&A should follow the guidance set forth in section 201, Agreed-Upon Procedures Engagements.[7] [Revised, November 2006, to reflect conforming changes necessary due to the issuance of SSAE No. 14.]

.03 This section does not—

a. Change the auditor's responsibility in an audit of financial statements performed in accordance with generally accepted auditing standards (GAAS).

b. Apply to situations in which the practitioner is requested to provide management with recommendations to improve the MD&A rather than to provide assurance. A practitioner engaged to provide such nonattest services should refer to CS section 100, *Consulting Services: Definitions and Standards*.

c. Apply to situations in which the practitioner is engaged to provide attest services with respect to an MD&A presentation that is prepared based on criteria other than the rules and regulations adopted by the SEC. A practitioner engaged to perform an examination or a review based upon such criteria should refer to the guidance in section 101, or to section 201 if engaged to perform an agreed-upon procedures engagement.[8]

.04 The requirements for MD&A have changed periodically since the first requirement was adopted by the SEC in 1974. As of the date of issuance of this SSAE, the rules and regulations for MD&A adopted by the SEC are found in Item 303 of Regulation S-K, as interpreted by Financial Reporting Release (FRR) No. 36, *Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures* (Chapter 5 of the "Codification of Financial Reporting Policies"); Item 303 of Regulation S-B for small business issuers; and Item 9 of Form 20-F for Foreign Private Issuers.[9] Item 303 of Regulation S-K, as interpreted by FRR No. 36, Item 303 of Regulation S-B for small business issuers, and Item 9 of Form 20-F for Foreign Private Issuers, provide the relevant rules and regulations adopted by the SEC

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[6] In this section, the terms *practitioner* or *accountant* generally refer to a person engaged to perform an attest service on MD&A. The term *accountant* may also refer to a person engaged to review financial statements. The term *auditor* refers to a person engaged to audit financial statements. As this section includes certain requirements for the practitioner to have audited or performed a review of financial statements in accordance with AU-C section 930, *Interim Financial Information*, the terms *auditor, practitioner*, or *accountant* may refer, in this section, to the same person. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

[7] Practitioners should follow guidance in AU-C section 920, *Letters for Underwriters and Certain Other Requesting Parties*, when requested to perform agreed-upon procedures on MD&A and report thereon in a letter for an underwriter. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

[8] The guidance in this section may be helpful when performing an engagement to provide attest services with respect to an MD&A presentation that is based on criteria other than the rules and regulations adopted by the SEC. Such other criteria would have to be suitable and available as discussed in paragraphs .23–.33 of section 101.

[9] The SEC staff from time to time issues guidance related to the SEC's adopted requirements; for example, Staff Accounting Bulletins (SABs), Staff Legal Bulletins, and speeches. Although such guidance may provide additional information with respect to the adopted requirements for MD&A, the practitioner should not be expected to attest to assertions on compliance with such guidance. The practitioner may find it helpful to also familiarize himself or herself with material contained on the SEC's website www.sec.gov that provides further information with respect to the SEC's views concerning MD&A disclosures.

that meet the definition of suitable criteria in paragraphs .23–.32 of section 101. The practitioner should consider whether the SEC has adopted additional rules and regulations with respect to MD&A subsequent to the issuance of this section.

Conditions for Engagement Performance

Examination

.05 The practitioner's objective in an engagement to examine MD&A is to express an opinion on the MD&A presentation taken as a whole by reporting whether—

a. The presentation includes, in all material respects, the required elements of the rules and regulations adopted by the SEC.[10]

b. The historical financial amounts have been accurately derived, in all material respects, from the entity's financial statements.[11]

c. The underlying information, determinations, estimates, and assumptions of the entity provide a reasonable basis for the disclosures contained therein.[12]

.06 A practitioner may accept an engagement to examine MD&A of a public or nonpublic entity, provided the practitioner audits, in accordance with GAAS,[13] the financial statements for at least the latest period to which the MD&A presentation relates and the financial statements for the other periods covered by the MD&A presentation have been audited by the practitioner or a predecessor auditor. A base knowledge of the entity and its operations gained through an audit of the historical financial statements and knowledge about the industry and the environment is necessary to provide the practitioner with sufficient knowledge to properly evaluate the results of the procedures performed in connection with the examination.

.07 If a predecessor auditor has audited the financial statements for a prior period covered by the MD&A presentation, the practitioner (the successor auditor) should also consider whether, under the particular circumstances, he or she can acquire sufficient knowledge of the business and of the entity's accounting and financial reporting practices for such period so that he or she would be able to—

a. Identify types of potential material misstatements in MD&A and consider the likelihood of their occurrence.

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[10] The required elements as of the date of issuance of this SSAE include a discussion of the entity's financial condition, changes in financial condition, and results of operations, including a discussion of liquidity and capital resources.

[11] Whether historical financial amounts are accurately derived from the financial statements includes both amounts that are derived from the face of the financial statements (which includes the notes to the financial statements) and financial statement schedules and those that are derived from underlying records supporting elements, accounts, or items included in the financial statements.

[12] Whether the underlying information, determinations, estimates, and assumptions of the entity provide a reasonable basis for the disclosures contained therein requires consideration of management's interpretation of the disclosure criteria for MD&A, management's determinations as to the relevancy of information to be included, and estimates and assumptions made by management that affect reported information.

[13] Restrictions on the scope of the audit of the financial statements will not necessarily preclude the practitioner from accepting an engagement to examine MD&A. Note that the SEC will generally not accept an auditor's report that is modified for a scope limitation. The practitioner should consider the nature and magnitude of the scope limitation and the form of the auditor's report in assessing whether an examination of MD&A could be performed.

b. Perform the procedures that will provide the practitioner with a basis for expressing an opinion as to whether the MD&A presentation includes, in all material respects, the required elements of the rules and regulations adopted by the SEC.

c. Perform the procedures that will provide the practitioner with a basis for expressing an opinion on the MD&A presentation with respect to whether the historical financial amounts have been accurately derived, in all material respects, from the entity's financial statements for such period.

d. Perform the procedures that will provide the practitioner with a basis for expressing an opinion as to whether the underlying information, determinations, estimates, and assumptions of the entity provide a reasonable basis for the disclosures contained therein.

Refer to paragraphs .99–.101 for guidance regarding the review of the predecessor auditor's working papers.

Review

.08 The objective of a review of MD&A is to report whether any information came to the practitioner's attention to cause him or her to believe that—

a. The MD&A presentation does not include, in all material respects, the required elements of the rules and regulations adopted by the SEC.

b. The historical financial amounts included therein have not been accurately derived, in all material respects, from the entity's financial statements.

c. The underlying information, determinations, estimates, and assumptions of the entity do not provide a reasonable basis for the disclosures contained therein.

A review consists principally of applying analytical procedures and making inquiries of persons responsible for financial, accounting, and operational matters. A review ordinarily does not contemplate (*a*) tests of accounting records through inspection, observation, or confirmation, (*b*) obtaining corroborating evidential matter in response to inquiries, or (*c*) the application of certain other procedures ordinarily performed during an examination of MD&A. A review may bring to the practitioner's attention significant matters affecting the MD&A, but it does not provide assurance that the practitioner will become aware of all significant matters that would be disclosed in an examination.

.09 A practitioner may accept an engagement to review the MD&A presentation of a public entity for an annual period provided the practitioner has audited, in accordance with GAAS, the financial statements for at least the latest annual period to which the MD&A presentation relates and the financial statements for the other periods covered by the MD&A presentation have been audited by the practitioner or a predecessor auditor.[14] A base knowledge of the entity and its operations gained through an audit of the historical financial

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[14] As discussed in paragraph .85*k*, a review report is not intended to be filed with the SEC as a report under the 1933 Act or the 1934 Act and, accordingly, the review report should contain a statement of restrictions on the use of the report to specified parties if the entity is (*a*) a public entity or (*b*) a nonpublic entity that is making or has made an offering of securities and it appears that the securities may subsequently be registered or subject to a filing with the SEC or other regulatory agency.

statements and knowledge about the industry and the environment is necessary to provide the practitioner with sufficient knowledge to properly evaluate the results of the procedures performed in connection with the review.

.10 If a predecessor auditor has audited the financial statements for a prior period covered by the MD&A presentation, the practitioner should also consider whether, under the particular circumstances, he or she can acquire sufficient knowledge of the business and of the entity's accounting and financial reporting practices for such period so he or she would be able to—

a. Identify types of potential material misstatements in the MD&A and consider the likelihood of their occurrence.

b. Perform the procedures that will provide the practitioner with a basis for reporting whether any information has come to the practitioner's attention to cause him or her to believe any of the following.

(1) The MD&A presentation does not include, in all material respects, the required elements of the rules and regulations adopted by the SEC.

(2) The historical financial amounts included therein have not been accurately derived, in all material respects, from the entity's financial statements for such period.

(3) The underlying information, determinations, estimates, and assumptions of the entity do not provide a reasonable basis for the disclosures contained therein.

.11 A practitioner may accept an engagement to review the MD&A presentation of a public entity for an interim period provided that both of the following conditions are met.

a. The practitioner performs either (*1*) a review of the historical financial statements for the related comparative interim periods and issues a review report thereon in accordance with AU-C section 930, *Interim Financial Information*, or (*2*) an audit of the interim financial statements.

b. The MD&A presentation for the most recent fiscal year has been or will be examined or reviewed by either the practitioner or a predecessor auditor.

[Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.12 If a predecessor auditor examined or reviewed the MD&A presentation of a public entity for the most recent fiscal year, the practitioner should not accept an engagement to review the MD&A presentation for an interim period unless he or she can acquire sufficient knowledge of the business and of the entity's accounting and financial reporting practices for the interim period to perform the procedures described in paragraph .10.

.13 If a nonpublic entity chooses to prepare MD&A, the practitioner should not accept an engagement to perform a review of such MD&A for an annual period under this section unless both of the following conditions are met.

a. The annual financial statements for the periods covered by the MD&A presentation have been or will be audited and the practitioner has audited or will audit the most recent year (refer to paragraph .07 if the financial statements for prior years were audited by a predecessor auditor).

b. Management will provide a written assertion that the presentation has been prepared using the rules and regulations adopted by the SEC as the criteria. (See paragraph .02.)

.14 A practitioner may accept an engagement to review the MD&A presentation of a nonpublic entity for an interim period provided that all of the following conditions are met.

a. The practitioner performs one of the following:

(1) A review of the historical financial statements for the related interim periods under the Statements on Standards for Accounting and Review Services (SSARSs) and issues a review report thereon

(2) A review of the condensed interim financial information for the related interim periods under AU-C section 930 and issues a review report thereon, and such interim financial information is accompanied by complete annual financial statements for the most recent fiscal year that have been audited

(3) An audit of the interim financial statements

b. The MD&A presentation for the most recent fiscal year has been or will be examined or reviewed.

c. Management will provide a written assertion stating that the presentation has been prepared using the rules and regulations adopted by the SEC as the criteria. (See paragraph .02.)

[Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Engagement Acceptance Considerations

.15 In determining whether to accept an engagement, the practitioner should consider whether management (and others engaged by management to assist them, such as legal counsel) has the appropriate knowledge of the rules and regulations adopted by the SEC to prepare MD&A.

Responsibilities of Management

.16 Management is responsible for the preparation of the entity's MD&A pursuant to the rules and regulations adopted by the SEC. The preparation of MD&A in conformity with the rules and regulations adopted by the SEC requires management to interpret the criteria, accurately derive the historical amounts from the entity's books and records, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information.

.17 An entity should not name the practitioner in a client-prepared document as having examined or reviewed MD&A unless the MD&A presentation and related practitioner's report and the related financial statements and auditor's (or accountant's review) report are included in the document (or, in the case of a public entity, incorporated by reference to such information filed with a regulatory agency). If such a statement is made in a document that does not include (or incorporate by reference) such information, the practitioner should request that neither his or her name nor reference to the practitioner be made with respect to the MD&A information, or that such document be revised to include the required presentations and reports. If the client does not comply, the practitioner should advise the client that he or she does not consent to either the use of his or her name or the reference to the practitioner, and he or she should consider what other actions might be appropriate.[15]

Obtaining an Understanding of the SEC Rules and Regulations and Management's Methodology for the Preparation of MD&A

.18 The practitioner should obtain an understanding of the rules and regulations adopted by the SEC for MD&A. (Refer to paragraph .04.)

.19 The practitioner should inquire of management regarding the method of preparing MD&A, including matters such as the sources of the information, how the information is gathered, how management evaluates the types of factors having a material effect on financial condition (including liquidity and capital resources), results of operations, and cash flows, and whether there have been any changes in the procedures from the prior year.

Timing of Procedures

.20 Proper planning by the practitioner contributes to the effectiveness of the attest procedures in an examination or a review of MD&A. Performing some of the work in conjunction with the audit of the historical financial statements or the review of interim financial statements may permit the work to be carried out in a more efficient manner and to be completed at an earlier date. When performing an examination or a review of MD&A, the practitioner may consider the results of tests of controls, analytical procedures,[16] and substantive tests performed in a financial statement audit or analytical procedures and inquiries made in a review of financial statements or interim financial information.

Materiality

.21 The practitioner should consider the concept of materiality in planning and performing the engagement. The objective of an examination or a review is to report on the MD&A presentation taken as a whole and not on the individual amounts and disclosures contained therein. In the context of an MD&A presentation, the concept of materiality encompasses both material omissions (for example, the omission of trends, events, and uncertainties that are currently known to management that are reasonably likely to have material effects on the entity's financial condition, results of operations, liquidity, or capital resources) and material misstatements in MD&A, both of which are referred to herein as a misstatement. Assessing the significance of a misstatement of some items in MD&A may be more dependent upon qualitative than

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[15] In considering what other actions, if any, may be appropriate in these circumstances, the practitioner may wish to consult his or her legal counsel.

[16] AU-C section 520, *Analytical Procedures*, defines analytical procedures as "evaluations of financial information through analysis of plausible relationships among both financial and nonfinancial data. Analytical procedures also encompass such investigation, as is necessary, of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount." In applying analytical procedures to MD&A, the practitioner develops expectations of matters that would be discussed in MD&A by identifying and using plausible relationships that are reasonably expected to exist based on the practitioner's understanding of the client and of the industry in which the client operates, and the knowledge of relationships among the various financial elements gained through the audit of financial statements or review of interim financial information. Refer to AU-C section 520 for further discussion of analytical procedures. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

quantitative considerations. Qualitative aspects of materiality relate to the relevance and reliability of the information presented (for example, qualitative aspects of materiality are considered in assessing whether the underlying information, determinations, estimates, and assumptions of the entity provide a reasonable basis for the disclosures in the MD&A). Furthermore, quantitative information is often more meaningful when accompanied by qualitative disclosures. For example, quantitative information about market risk-sensitive instruments is more meaningful when accompanied by qualitative information about an entity's market risk exposures and how those exposures are managed. Materiality is also a concept that is judged in light of the expected range of reasonableness of the information; therefore, users should not expect prospective information (information about events that have not yet occurred) to be as precise as historical information.

.22 In expressing an opinion, or providing the limited assurance of a review engagement, on the presentation, the practitioner should consider the omission or misstatement of an individual assertion (see paragraph .34) to be material if the magnitude of the omission or misstatement—individually or when aggregated with other omissions or misstatements—is such that a reasonable person using the MD&A presentation would be influenced by the inclusion or correction of the individual assertion. The relative rather than absolute size of an omission or misstatement may determine whether it is material in a given situation.

Inclusion of Pro Forma Financial Information

.23 Management may include pro forma financial information with respect to a business combination or other transactions in MD&A. The practitioner should consider the guidance in paragraph .10 of section 401, *Reporting on Pro Forma Financial Information*, when performing procedures with respect to such information, even if management indicates in MD&A that certain information has been derived from unaudited financial statements. For example, in an examination of MD&A, the practitioner's procedures would ordinarily include obtaining an understanding of the underlying transaction or event, discussing with management their assumptions, obtaining sufficient evidence in support of the adjustments, and other procedures for the purpose of expressing an opinion on the MD&A presentation taken as a whole and not for expressing an opinion on (or providing the limited assurance of a review of) the pro forma financial information included therein under section 401.

Inclusion of External Information

.24 An entity may also include in its MD&A information external to the entity, such as the rating of its debt by certain rating agencies or comparisons with statistics from a trade association. Such external information should also be subjected to the practitioner's examination or review procedures. For example, in an examination, the practitioner might compare information concerning the statistics of a trade organization to a published source; however, the practitioner would not be expected to test the underlying support for the trade association's calculation of such statistics.

Inclusion of Forward-Looking Information

.25 An entity may include certain forward-looking disclosures in the MD&A presentation, including cautionary language concerning the achievability of the matters disclosed. Although any forward-looking disclosures that are included in the MD&A presentation should be subjected to the practitioner's examination or review, such information is subjected to testing only for the purpose of expressing an opinion that the underlying information, determinations, estimates, and assumptions provide a reasonable basis for the disclosures contained therein or providing the limited assurance of a review on the MD&A presentation taken as a whole. The practitioner may consider the guidance in section 301, *Financial Forecasts and Projections*, when performing procedures with respect to forward-looking information. The practitioner may also consider whether meaningful cautionary language has been included with the forward-looking information.

.26 Section 27A of the Securities Act of 1933 (the 1933 Act) and Section 21E of the Securities Exchange Act of 1934 (the 1934 Act) provide a safe harbor from liability in private litigation with respect to forward-looking statements that include or make reference to meaningful cautionary language. However, such sections also include exclusions from safe harbor protection in certain situations. Whether an entity's forward-looking statements and the practitioner's report thereon qualify for safe harbor protection is a legal matter.

Inclusion of Voluntary Information

.27 An entity may voluntarily include other information in the MD&A presentation that is not required by the rules and regulations adopted by the SEC for MD&A. When the entity includes in MD&A additional information required by other rules and regulations of the SEC (for example, Item 305 of Regulation S-K, *Quantitative and Qualitative Disclosures About Market Risk*), the practitioner should also consider such other rules and regulations in subjecting such information to his or her examination or review procedures.[17]

Examination Engagement

.28 To express an opinion about whether (*a*) the presentation includes, in all material respects, the required elements of the rules and regulations adopted by the SEC, (*b*) the historical financial amounts have been accurately derived, in all material respects, from the entity's financial statements, and (*c*) the underlying information, determinations, estimates, and assumptions of the entity provide a reasonable basis for the disclosures contained therein, the practitioner seeks to obtain reasonable assurance by accumulating sufficient evidence in support of the disclosures and assumptions, thereby restricting attestation risk to an appropriately low level.

Attestation Risk

.29 In an engagement to examine MD&A, the practitioner plans and performs the examination to obtain reasonable assurance of detecting both intentional and unintentional misstatements that are material to the MD&A presentation taken as a whole. Absolute assurance is not attainable because of factors such as the need for judgment regarding the areas to be tested and the nature, timing, and extent of tests to be performed; the concept of selective testing of the data; and the inherent limitations of the controls applicable to the preparation of MD&A. The practitioner exercises professional judgment in

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[17] To the extent that the voluntary information includes forward-looking information, refer to paragraphs .25–.26.

assessing the significant determinations made by management as to the relevancy of information to be included, and the estimates and assumptions that affect reported information. As a result of these factors, in the great majority of cases, the practitioner has to rely on evidence that is persuasive rather than convincing. Also, procedures may be ineffective for detecting an intentional misstatement that is concealed through collusion among client personnel and third parties or among management or employees of the client. Therefore, the subsequent discovery that a material misstatement exists in the MD&A does not, in and of itself, evidence (*a*) failure to obtain reasonable assurance; (*b*) inadequate planning, performance, or judgment on the part of the practitioner; (*c*) the absence of due professional care; or (*d*) a failure to comply with this section.

.30 Factors to be considered by the practitioner in planning an examination of MD&A include (*a*) the anticipated level of attestation risk related to assertions embodied in the MD&A presentation, (*b*) preliminary judgments about materiality for attest purposes, (*c*) the items within the MD&A presentation that are likely to require revision or adjustment, and (*d*) conditions that may require extension or modification of attest procedures. For purposes of an engagement to examine MD&A, the components of attestation risk are defined as follows.

a. *Inherent risk* is the susceptibility of an assertion within MD&A to a material misstatement, assuming that there are no related controls. (See paragraphs .34–.38.)

b. *Control risk* is the risk that a material misstatement that could occur in an assertion within MD&A will not be prevented or detected on a timely basis by the entity's controls; some control risk will always exist because of the inherent limitations of any internal control.

c. *Detection risk* is the risk that the practitioner will not detect a material misstatement that exists in an assertion within MD&A.

Inherent Risk

.31 The level of inherent risk varies with the nature of the assertion. For example, the inherent risk concerning financial information included in the MD&A presentation may be low, whereas the inherent risk concerning the completeness of the disclosure of the entity's risks or liquidity may be high.

Control Risk

.32 The practitioner should assess control risk as discussed in paragraphs .53–.57. Assessing control risk contributes to the practitioner's evaluation of the risk that material misstatement in the MD&A exists. In the process of assessing control risk (together with assessing inherent risk), the practitioner may obtain evidential matter about the risk that such misstatement may exist. The practitioner uses this evidential matter as part of the reasonable basis for his or her opinion on the MD&A presentation taken as a whole.

Detection Risk

.33 In determining an acceptable level of detection risk, the practitioner assesses inherent risk and control risk, and considers the extent to which he or she seeks to restrict attestation risk. As assessed inherent risk or control risk decreases, the acceptable level of detection risk increases. Accordingly, the practitioner may alter the nature, timing, and extent of tests performed based on the assessments of inherent risk and control risk.

Nature of Assertions

.34 Assertions are representations by management that are embodied in the MD&A presentation. They can be either explicit or implicit and can be classified according to the following broad categories:

a. Occurrence

b. Consistency with the financial statements

c. Completeness

d. Presentation and disclosure

.35 Assertions about occurrence address whether reported transactions or events have occurred during a given period. Assertions about consistency with the financial statements address whether—

a. Reported transactions, events, and explanations are consistent with the financial statements.

b. Historical financial amounts have been accurately derived from the financial statements and related records.

c. Nonfinancial data have been accurately derived from related records.

.36 Assertions about completeness address whether descriptions of transactions and events necessary to obtain an understanding of the entity's financial condition (including liquidity and capital resources), changes in financial condition, results of operations, and material commitments for capital resources are included in MD&A; and whether known events, transactions, conditions, trends, demands, commitments, or uncertainties that will result in or are reasonably likely to result in material changes to these items are appropriately described in the MD&A presentation.

.37 For example, if management asserts that the reason for an increase in revenues is a price increase in the current year, they are explicitly asserting that both an increase in revenues and a price increase have occurred in the current year, and implicitly asserting that any historical financial amounts included are consistent with the financial statements for such period. They are also implicitly asserting that the explanation for the increase in revenues is complete; that there are no other significant reasons for the increase in revenues.

.38 Assertions about presentation and disclosure address whether information included in the MD&A presentation is properly classified, described, and disclosed. For example, management asserts that any forward-looking information included in MD&A is properly classified as being based on management's present assessment and includes an appropriate description of the expected results. To further disclose the nature of such information, management may also include a statement that actual results in the future may differ materially from management's present assessment. (See paragraphs .25–.26.)

.39 The auditor of the underlying financial statements is responsible for designing and performing audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion, as discussed in AU-C section 500, *Audit Evidence*. Although procedures designed to achieve the practitioner's objective of forming an opinion on the MD&A presentation taken as a whole may test certain assertions embodied in the underlying financial statements, the practitioner is not expected to test the underlying financial statement assertions in an examination of MD&A. For example, the practitioner is not expected to test the completeness of revenues or the existence of inventory when testing the assertions in MD&A concerning an increase in revenues or an increase in inventory levels; assurance related to completeness of revenues or for existence of inventory would be obtained as part of the audit. The practitioner is, however, responsible for testing the completeness of the explanation for the increase in revenues or the increase in inventory levels. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Performing an Examination Engagement

.40 The practitioner should exercise (*a*) due professional care in planning, performing, and evaluating the results of his or her examination procedures and (*b*) the proper degree of professional skepticism to obtain reasonable assurance that material misstatements will be detected.

.41 In an examination of MD&A, the practitioner should perform the following.

a. Obtain an understanding of the rules and regulations adopted by the SEC for MD&A and management's method of preparing MD&A. (See paragraphs .18–.19.)

b. Plan the engagement. (See paragraphs .42–.48.)

c. Consider relevant portions of the entity's internal control applicable to the preparation of MD&A. (See paragraphs .49–.58.)

d. Obtain sufficient evidence, including testing completeness. (See paragraphs .59–.64.)

e. Consider the effect of events subsequent to the balance-sheet date. (See paragraphs .65–.66.)

f. Obtain written representations from management concerning its responsibility for MD&A, completeness of minutes, events subsequent to the balance-sheet date, and other matters about which the practitioner believes written representations are appropriate. (See paragraphs .110–.112.)

g. Form an opinion about whether the MD&A presentation includes, in all material respects, the required elements of the rules and regulations adopted by the SEC, whether the historical financial amounts included therein have been accurately derived, in all material respects, from the entity's financial statements, and whether the underlying information, determinations, estimates, and assumptions of the entity provide a reasonable basis for the disclosures contained in the MD&A. (See paragraph .67.)

Planning the Engagement

General Considerations

.42 Planning an engagement to examine MD&A involves developing an overall strategy for the expected scope and performance of the engagement. When developing an overall strategy for the engagement, the practitioner should consider factors such as the following:

- Matters affecting the industry in which the entity operates, such as financial reporting practices, economic conditions, laws and regulations, and technological changes
- Knowledge of the entity's internal control applicable to the preparation of MD&A obtained during the audit of the financial statements and the extent of recent changes, if any
- Matters relating to the entity's business, including its organization, operating characteristics, capital structure, and distribution methods
- The types of relevant information that management reports to external analysts (for example, press releases and presentations to lenders and rating agencies, if any, concerning past and future performance)
- How the entity analyzes actual performance compared to budgets and the types of information provided in documents submitted to the board of directors for purposes of the entity's day-to-day operations and long-range planning
- The extent of management's knowledge of and experience with the rules and regulations adopted by the SEC for MD&A
- If the entity is a nonpublic entity, the intended use of the MD&A presentation
- Preliminary judgments about (*a*) materiality, (*b*) inherent risk at the individual assertion level, and (*c*) factors (for example, matters identified during the audit or review of the historical financial statements) relating to significant deficiencies in internal control applicable to the preparation of MD&A (See paragraph .58.)
- The fraud risk factors or other conditions identified during the audit of the most recent annual financial statements and the practitioner's response to such risk factors
- The type and extent of evidential matter supporting management's assertions and disclosures in the MD&A presentation
- The nature of complex or subjective matters potentially material to the MD&A presentation that may require special skill or knowledge and whether such matters may require using the work of a specialist to obtain sufficient evidential matter (See paragraph .47.)
- The presence of an internal audit function (See paragraph .48.)

.43 In planning an engagement when MD&A has not previously been examined, the practitioner should consider the degree to which the entity has information available for such prior periods and the continuity of the entity's personnel and their ability to respond to inquiries with respect to such periods. In addition, the practitioner should obtain an understanding of the entity's internal control in prior years applicable to the preparation of MD&A.

Consideration of Audit Results

.44 The practitioner should also consider the results of the audits of the financial statements for the periods covered by the MD&A presentation on the examination engagement, such as matters relating to the following:

- The availability and condition of the entity's records
- The nature and magnitude of audit adjustments

- Misstatements[18] that were not corrected in the financial statements that may affect MD&A disclosures (for example, misclassifications between financial statement line items)

[Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.45 The practitioner should also consider the possible impact on the scope of the examination engagement of any modification or contemplated modification of the auditor's report, including matters addressed in explanatory language. For example, if the auditor has modified the auditor's report to include a going-concern uncertainty explanatory paragraph, the practitioner would consider such a matter in assessing attestation risk.

Multiple Components

.46 In an engagement to examine MD&A, if the entity has operations in several components (for example, locations, branches, subsidiaries, or programs), the practitioner examining the group's MD&A should determine the components to which procedures should be applied. In making such a determination and in selecting the components to be tested, the practitioner examining the group's MD&A should consider factors such as the following:

- The relative importance of each component to the applicable disclosure in the group's MD&A
- The degree of centralization of records
- The effectiveness of controls, particularly those that affect group management's direct control over the exercise of authority delegated to others and its ability to supervise activities at various locations effectively
- The nature and extent of operations conducted at the various components
- The similarity of operations and internal control for different components

The practitioner examining the group's MD&A should consider whether the audit base of the components is consistent with the components that are disclosed in MD&A Accordingly, it may be desirable for the practitioner examining the group's MD&A to coordinate the audit work with the components that will be disclosed. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Using the Work of a Specialist

.47 In some engagements to examine MD&A, the nature of complex or subjective matters potentially material to the MD&A presentation may require specialized skill or knowledge in a particular field other than accounting or auditing. For example, the entity may include information concerning plant production capacity, which would ordinarily be determined by an engineer. In such cases, the practitioner may use the work of a specialist and should consider the relevant guidance in AU-C section 620, *Using the Work of an Auditor's Specialist*. An auditor's specialist may be either an auditor's internal specialist (for example, a partner of the auditor's firm) or an external specialist. [Revised,

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[18] Refer to paragraphs .05–.06 and .11–.13 of AU-C section 320, *Materiality in Planning and Performing an Audit*, and paragraph .10 of AU-C section 450, *Evaluation of Misstatements Identified During the Audit*. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Internal Audit Function

.48 Another factor the practitioner should consider when planning the engagement is whether the entity has an internal audit function and the extent to which internal auditors are involved in directly testing the MD&A presentation, in monitoring the entity's internal control applicable to the preparation of MD&A, or in testing the underlying records supporting disclosures in the MD&A. A practitioner should consider the guidance in AU-C section 610, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*, when addressing the competence and objectivity of internal auditors; the nature, timing, and extent of work to be performed; and other related matters. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Consideration of Internal Control Applicable to the Preparation of MD&A

.49 The practitioner should obtain an understanding of the entity's internal control applicable to the preparation of MD&A sufficient to plan the engagement and to assess control risk. Generally, controls that are relevant to an examination pertain to the entity's objective of preparing MD&A in conformity with the rules and regulations adopted by the SEC, and may include controls within the control environment, risk assessment, information and communication, control activities, and monitoring components.

.50 The controls relating to operations and compliance objectives may be relevant to an examination if they pertain to data the practitioner evaluates or uses in applying examination procedures. For example, controls over the gathering of information, which are different from financial statement controls, and controls relating to nonfinancial data that are included in the MD&A presentation, may be relevant to an examination engagement.

.51 In planning the examination, knowledge of such controls should be used to identify types of potential misstatement (including types of potential material omissions), to consider factors that affect the risk of material misstatement and to design appropriate tests.

.52 A practitioner generally obtains an understanding of the design of the entity's internal control applicable to the preparation of MD&A by making inquiries of appropriate management, supervisory, and staff personnel; by inspection of the entity's documents; and by observation of the entity's relevant activities, including controls over matters discussed, nonfinancial data included, and management evaluation of the reasonableness of information included. The nature and extent of procedures a practitioner performs vary from entity to entity and are influenced by factors such as the entity's complexity, the length of time that the entity has prepared MD&A pursuant to the rules and regulations adopted by the SEC, the practitioner's knowledge of the entity's controls obtained in audits and previous professional engagements, and judgments about materiality.

.53 After obtaining an understanding of the entity's internal control applicable to the preparation of MD&A, the practitioner assesses control risk for the assertions embodied in the MD&A presentation. (Refer to paragraphs .34–.39.) The practitioner may assess control risk at the maximum level (the greatest probability that a material misstatement that could occur in an assertion will not be prevented or detected on a timely basis by an entity's controls) because the practitioner believes controls are unlikely to pertain to an assertion, are unlikely to be effective, or because evaluating their effectiveness would be inefficient. Alternatively, the practitioner may obtain evidential matter about the effectiveness of both the design and operation of a control that supports a lower assessed level of control risk. Such evidential matter may be obtained from tests of controls planned and performed concurrently with obtaining the understanding of the internal control or from procedures performed to obtain the understanding that were not specifically planned as tests of controls.

.54 After obtaining the understanding and assessing control risk, the practitioner may desire to seek a further reduction in the assessed level of control risk for certain assertions. In such cases, the practitioner considers whether evidential matter sufficient to support a further reduction is likely to be available and whether performing additional tests of controls to obtain such evidential matter would be efficient.

.55 When seeking to assess control risk below the maximum for controls over financial and nonfinancial data, the practitioner should perform tests of controls to obtain evidence to support the assessed level of control risk. For example, the practitioner may perform tests of controls directed toward the effectiveness of the design or operation of internal control over the accumulation of the number of units sold for a manufacturing company, average interest rates earned and paid for a financial institution, or average net sales per square foot for a retail entity.

.56 The practitioner uses the knowledge provided by the understanding of internal control applicable to the preparation of MD&A and the assessed level of control risk in determining the nature, timing, and extent of substantive tests for the MD&A assertions.

.57 The practitioner should document the understanding of the internal control components obtained to plan the examination and the assessment of control risk. The form and extent of this documentation is influenced by the size and complexity of the entity, as well as the nature of the entity's controls applicable to the preparation of MD&A.

.58 During the course of an engagement to examine MD&A, the practitioner may become aware of control deficiencies in the design or operation of controls applicable to the preparation of MD&A that could adversely affect the entity's ability to prepare MD&A in accordance with the rules and regulations adopted by the SEC. The practitioner should consider the implications of such control deficiencies on his or her ability to rely on management's explanations and on comparisons to summary accounting records. A practitioner's responsibility to communicate these control deficiencies in an examination of MD&A is similar to the auditor's responsibility described in AU-C section 265, *Communicating Internal Control Related Matters Identified in an Audit*, and AU-C section 260, *The Auditor's Communication With Those Charged With Governance*. [Revised, March 2006, to reflect conforming changes necessary due to the issuance of SAS No. 112. Revised, January 2010, to reflect conforming changes necessary due to the issuance of SAS No. 115. Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Obtaining Sufficient Evidence

.59 The practitioner should apply procedures to obtain reasonable assurance of detecting material misstatements. In an audit of historical financial statements, the practitioner will have applied audit procedures to some of the information included in the MD&A. However, because the objective of those audit procedures is to have a reasonable basis for expressing an opinion on the financial statements taken as a whole rather than on the MD&A, certain additional examination procedures should be performed as discussed in paragraphs .60–.64. Determining these procedures and evaluating the sufficiency of the evidence obtained are matters of professional judgment.

.60 The practitioner ordinarily should apply the following procedures.

a. Read the MD&A and compare the content for consistency with the audited financial statements; compare financial amounts to the audited financial statements or related accounting records and analyses; recompute the increases, decreases, and percentages disclosed.

b. Compare nonfinancial amounts to the audited financial statements, if applicable, or to other records. (Refer to paragraphs .62–.64.)

c. Consider whether the explanations in MD&A are consistent with the information obtained during the audit; investigate further those explanations that cannot be substantiated by information in the audit working papers through inquiry (including inquiry of officers and other executives having responsibility for operational areas) and inspection of client records.

d. Examine internally generated documents (for example, variance analyses, sales analyses, wage cost analyses, sales or service pricing sheets, and business plans or programs) and externally generated documents (for example, correspondence, contracts, or loan agreements) in support of the existence, occurrence, or expected occurrence of events, transactions, conditions, trends, demands, commitments, and uncertainties disclosed in the MD&A.

e. Obtain available prospective financial information (for example, budgets; sales forecasts; forecasts of labor, overhead, and materials costs; capital expenditure requests; and financial forecasts and projections) and compare such information to forward-looking MD&A disclosures. Inquire of management as to the procedures used to prepare the prospective financial information. Evaluate whether the underlying information, determinations, estimates, and assumptions of the entity provide a reasonable basis for the MD&A disclosures of events, transactions, conditions, trends, demands, commitments, or uncertainties.[19]

f. Consider obtaining available prospective financial information relating to prior periods and comparing actual results with forecasted and projected amounts.

g. Make inquiries of officers and other executives having responsibility for operational areas (such as sales, marketing, and production) and financial and accounting matters, as to their plans and expectations for the future that could affect the entity's liquidity and capital resources.

h. Consider obtaining external information concerning industry trends, inflation, and changing prices and comparing the related MD&A disclosures to such information.

i. Compare the information in MD&A with the rules and regulations adopted by the SEC and consider whether the presentation includes the required elements of such rules and regulations.

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[19] Refer to paragraph .26 for a discussion concerning the safe harbor rules for forward-looking statements.

j. Read the minutes of meetings to date of the board of directors and other significant committees to identify matters that may affect MD&A; consider whether such matters are appropriately addressed in MD&A.

k. Inquire of officers as to the entity's prior experience with the SEC and the extent of comments received upon review of documents by the SEC; read correspondence between the entity and the SEC with respect to such review, if any.

l. Obtain public communications (for example, press releases and quarterly reports) and the related supporting documentation dealing with historical and future results; consider whether MD&A is consistent with such communications.

m. Consider obtaining other types of publicly available information (for example, analyst reports and news articles); compare the MD&A presentation with such information.

Testing Completeness

.61 The practitioner should design procedures to test the presentation for completeness, including tests of the completeness of explanations that relate to historical disclosures as discussed in paragraphs .36–.37. The practitioner should also consider whether the MD&A discloses matters that could significantly impact future financial condition and results of operations of the entity by considering information that he or she obtained through the following:

a. Audit of the financial statements

b. Inquiries of the entity's officers and other executives directed to current events, conditions, economic changes, commitments and uncertainties, within both the entity and its industry

c. Other information obtained through procedures such as those listed in paragraphs .60 and .65–.66

As discussed in paragraph .31, the inherent risk concerning the completeness of disclosures may be high; if it is, the practitioner may extend the procedures (for example, by making additional inquiries of management or by examining additional internally generated documents).

Nonfinancial Data

.62 Management may include nonfinancial data (such as units produced; the number of units sold, locations, or customers; plant utilization; or square footage) in the MD&A. The practitioner should consider whether the definitions used by management for such nonfinancial data are reasonable for the particular disclosure in the MD&A and whether there are suitable criteria (for example, industry standards with respect to square footage for retail operations), as discussed in paragraphs .23–.32 of section 101.

.63 In some situations, the nonfinancial data or the controls over the nonfinancial data may have been tested by the practitioner in conjunction with the financial statement audit; however, the practitioner's consideration of the nature of the procedures to apply to nonfinancial data in an examination of MD&A is based on the concept of materiality with respect to the MD&A presentation. The practitioner should consider whether industry standards exist for the nonfinancial data or whether there are different methods of measurement that may be used, and, if such methods could result in significantly different results, whether the method of measurement selected by management is reasonable and consistent between periods covered by the MD&A presentation. For example, the number of customers reported by management could vary depending on whether management defines a customer as a subsidiary or "ship to" location of a company rather than the company itself.

.64 In testing nonfinancial data included in the MD&A, the practitioner may seek to assess control risk below the maximum for controls over such nonfinancial data, as discussed in paragraph .55. The practitioner weighs the increase in effort of the examination associated with the additional tests of controls that is necessary to obtain evidential matter against the resulting decrease in examination effort associated with the reduced substantive tests. For those nonfinancial assertions for which the practitioner performs additional tests of controls, the practitioner determines the assessed level of control risk that the results of those tests will support. This assessed level of control risk is used in determining the appropriate detection risk to accept for those nonfinancial assertions and, accordingly, in determining the nature, timing, and extent of substantive tests for such assertions.

Consideration of the Effect of Events Subsequent to the Balance-Sheet Date

.65 As there is an expectation by the SEC that MD&A considers events through a date at or near the filing date,[20] the practitioner should consider information about events[21] that comes to his or her attention after the end of the period addressed by MD&A and prior to the issuance of his or her report that may have a material effect on the entity's financial condition (including liquidity and capital resources), changes in financial condition, results of operations, and material commitments for capital resources. Events or matters that should be disclosed in MD&A include those that—[22]

- Are reasonably expected to have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations.
- Are reasonably likely to result in the entity's liquidity increasing or decreasing in any material way.
- Will have a material effect on the entity's capital resources.
- Would cause reported financial information not to be necessarily indicative of future operating results or of future financial condition.

The practitioner should consider whether events identified during the examination of the MD&A presentation or the audit of the related financial statements require adjustment to or disclosure in the MD&A presentation. When MD&A will be included or incorporated by reference in a 1933 Act document that is filed with the SEC, the practitioner's procedures should extend up to the filing

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[20] A registration statement under the 1933 Act speaks as of its effective date.

[21] Such events are only referred to as *subsequent events* in relation to an MD&A presentation if they occur after the MD&A presentation has been issued. The annual MD&A presentation ordinarily would not be updated for subsequent events if an MD&A presentation for a subsequent interim period has been issued or the event has been reported through a filing on Form 8-K.

[22] The practitioner should refer to the rules and regulations adopted by the SEC for other examples of events that should be disclosed.

date or as close to it as is reasonable and practicable in the circumstances.[23] If a public entity's MD&A presentation is to be included only in a filing under the 1934 Act (for example, Forms 10-K or 10-KSB), the practitioner's responsibility to consider subsequent events does not extend beyond the date of the report on MD&A. Paragraphs .94–.98 provide guidance when the practitioner is engaged subsequent to the filing of the MD&A presentation.

.66 In an examination of MD&A, the practitioner's fieldwork ordinarily extends beyond the date of the auditor's report on the related financial statements.[24] Accordingly, the practitioner generally should—

a. Read available minutes of meetings of stockholders, the board of directors, and other appropriate committees; as to meetings for which minutes are not available, inquire about matters dealt with at such meetings.

b. Read the latest available interim financial statements for periods subsequent to the date of the auditor's report, compare them with the financial statements for the periods covered by the MD&A, and inquire of and discuss with officers and other executives having responsibility for operational, financial, and accounting matters (limited where appropriate to major locations) matters such as the following:

- Whether interim financial statements have been prepared on the same basis as the audited financial statements
- Whether there were any significant changes in the entity's operations, liquidity, or capital resources in the subsequent period
- The current status of items in the financial statements for which the MD&A has been prepared that were accounted for on the basis of tentative, preliminary, or inconclusive data
- Whether any unusual adjustments were made during the period from the balance-sheet date to the date of inquiry

c. Make inquiries of members of senior management as to the current status of matters concerning litigation, claims, and assessments identified during the audit of the financial statements and of any new matters or unfavorable developments. Consider obtaining updated legal letters from legal counsel.[25]

d. Consider whether there have been any changes in economic conditions or in the industry that could have a significant effect on the entity.

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[23] Additionally, if the practitioner's report on MD&A is included or incorporated by reference in a 1933 Act document, the practitioner should extend his or her procedures with respect to subsequent events from the date of his or her report on MD&A up to the effective date or as close thereto as is reasonable and practicable in the circumstances.

[24] Undertaking an engagement to examine MD&A does not extend the auditor's responsibility to update the subsequent events review procedures for the financial statements beyond the date of the auditor's report. However, see AU-C section 560, *Events and Subsequently Discovered Facts*. Also, see AU-C section 925, *Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933*, as to an auditor's responsibility when his or her report is included in a registration statement filed under the 1933 Act. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

[25] See paragraphs .16–.24 of AU-C section 501, *Audit Evidence—Specific Considerations for Selected Items*, for guidance concerning obtaining legal letters. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

e. Obtain written representations from appropriate officials as to whether any events occurred subsequent to the latest balance-sheet date that would require disclosure in the MD&A. (See paragraphs .110–.112.)

f. Make such additional inquiries or perform such other procedures as considered necessary and appropriate to address questions that arise in carrying out the foregoing procedures, inquiries, and discussions.

Forming an Opinion

.67 The practitioner should consider the concept of materiality discussed in paragraphs .21–.22, and the impact of any modification of the auditor's report on the historical financial statements in forming an opinion on the examination of MD&A, including the practitioner's ability to evaluate the results of inquiries and other procedures.

Reporting

.68 In order for the practitioner to issue a report on an examination of MD&A, the financial statements for the periods covered by the MD&A presentation and the related auditor's report(s) should accompany the MD&A presentation (or, with respect to a public entity, be incorporated in the document containing the MD&A by reference to information filed with a regulatory agency). In addition, if the entity is a nonpublic entity, one of the following conditions should be met.

a. A statement should be included in the body of the MD&A presentation that it has been prepared using the rules and regulations adopted by the SEC.

b. A separate written assertion should accompany the MD&A presentation or such assertion should be included in a representation letter obtained from the entity.

.69 The practitioner's report on an examination of MD&A should include the following:

a. A title that includes the word *independent*

b. An identification of the MD&A presentation, including the period covered

c. A statement that management is responsible for the preparation of the MD&A pursuant to the rules and regulations adopted by the SEC, and a statement that the practitioner's responsibility is to express an opinion on the presentation based on his or her examination

d. A reference to the auditor's report on the related financial statements, and if the report was other than a standard report, the substantive reasons therefor

e. A statement that the examination was conducted in accordance with attestation standards established by the AICPA and a description of the scope of an examination of MD&A

f. A statement that the practitioner believes the examination provides a reasonable basis for his or her opinion *g.* A paragraph stating that—

(1) The preparation of MD&A requires management to interpret the criteria, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information

(2) Actual results in the future may differ materially from management's present assessment of information regarding the estimated future impact of transactions and events that have occurred or are expected to occur, expected sources of liquidity and capital resources, operating trends, commitments, and uncertainties

h. If the entity is a nonpublic entity, a statement that, although the entity is not subject to the rules and regulations of the SEC, the MD&A presentation is intended to be a presentation in accordance with the rules and regulations adopted by the SEC

i. The practitioner's opinion on whether—

(1) The presentation includes, in all material respects, the required elements of the rules and regulations adopted by the SEC

(2) The historical financial amounts have been accurately derived, in all material respects, from the entity's financial statements

(3) The underlying information, determinations, estimates, and assumptions of the entity provide a reasonable basis for the disclosures contained therein

j. The manual or printed signature of the practitioner's firm

k. The date of the examination report

Appendix A [paragraph .114], "Examination Reports," includes a standard examination report. (See Example 1.)

Dating

.70 The practitioner's report on the examination of MD&A should be dated as of the completion of the practitioner's examination procedures. That date should not precede the date of the auditor's report on the latest historical financial statements covered by the MD&A.

Report Modifications

.71 The practitioner should modify the standard report described in paragraph .69, if any of the following conditions exist.

- The presentation excludes a material required element under the rules and regulations adopted by the SEC. (See paragraph .72.)
- The historical financial amounts have not been accurately derived, in all material respects, from the entity's financial statements. (See paragraph .72.)
- The underlying information, determinations, estimates, and assumptions used by management do not provide the entity with a reasonable basis for the disclosure in the MD&A. (See paragraph .72.)
- There is a restriction on the scope of the engagement. (See paragraph .73.)

- The practitioner decides to refer to the report of another practitioner as the basis in part for his or her report. (See paragraph .74.)

- The practitioner is engaged to examine the MD&A presentation after it has been filed with the SEC or other regulatory agency. (See paragraphs .94–.98.)

.72 The practitioner should express a qualified or an adverse opinion if (*a*) the MD&A presentation excludes a material required element, (*b*) historical financial amounts have not been accurately derived in all material respects, or (*c*) the underlying information, determinations, estimates, and assumptions of the entity do not provide a reasonable basis for the disclosures; for example, if there is a lack of consistency between management's method of measuring nonfinancial data between periods covered by the MD&A presentation. The basis for such opinion should be stated in the practitioner's report. Appendix A [paragraph .114] includes several examples of such modifications. (See Example 2.) Also refer to paragraph .107 for required communications with the audit committee.

.73 If the practitioner is unable to perform the procedures he or she considers necessary in the circumstances, the practitioner should modify the report or withdraw from the engagement. If the practitioner modifies the report, he or she should describe the limitation on the scope of the examination in an explanatory paragraph and qualify his or her opinion, or disclaim an opinion. However, limitations on the ability of the practitioner to perform necessary procedures could also arise because of the lack of adequate support for a significant representation in the MD&A. That circumstance may result in a conclusion that the unsupported representation constitutes a material misstatement of fact and, accordingly, the practitioner may qualify his or her opinion or express an adverse opinion, as described in paragraph .72.

Reference to Report of Another Practitioner

.74 If another practitioner examined the MD&A presentation of a component (refer to paragraph .46), the practitioner examining the group's MD&A may decide to make reference to such report of the component practitioner as a basis for his or her opinion on the group's consolidated MD&A presentation. The practitioner examining the group's MD&A should disclose this fact in the introductory paragraph of the report and should refer to the report of the component practitioner in expressing an opinion on the group's consolidated MD&A presentation. These references indicate (1) that the practitioner examining the group's MD&A is not taking responsibility for the work of the component practitioner, and (2) the source of the examination evidence with respect to those components for which reference to the examination of component practitioners is made. Appendix A [paragraph .114] provides an example of a report for such a situation. (See example 3.) Refer to paragraph .105 for guidance when the other practitioner does not issue a report. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Emphasis of a Matter

.75 In a number of circumstances, the practitioner may wish to emphasize a matter regarding the MD&A presentation. For example, he or she may wish to emphasize that the entity has included information beyond the required elements of the rules and regulations adopted by the SEC. Such explanatory comments should be presented in a separate paragraph of the practitioner's report.

Review Engagement

.76 The objective of a review engagement, including a review of MD&A for an interim period, is to accumulate sufficient evidence to provide the practitioner with a basis for reporting whether any information came to the practitioner's attention to cause him or her to believe that (*a*) the MD&A presentation does not include, in all material respects, the required elements of the rules and regulations adopted by the SEC, (*b*) the historical financial amounts included therein have not been accurately derived, in all material respects, from the entity's financial statements, or (*c*) the underlying information, determinations, estimates, and assumptions of the entity do not provide a reasonable basis for the disclosures contained therein. MD&A for an interim period may be a free-standing presentation or it may be combined with the MD&A presentation for the most recent fiscal year. Procedures for conducting a review of MD&A generally are limited to inquiries and analytical procedures, rather than also including search and verification procedures, concerning factors that have a material effect on financial condition, including liquidity and capital resources, results of operations, and cash flows. In a review engagement, the practitioner should—

a. Obtain an understanding of the rules and regulations adopted by the SEC for MD&A and management's method of preparing MD&A. (See paragraphs .18–.19.)

b. Plan the engagement. (See paragraph .77.)

c. Consider relevant portions of the entity's internal control applicable to the preparation of the MD&A. (See paragraph .78.)

d. Apply analytical procedures and make inquiries of management and others. (See paragraphs .79–.80.)

e. Consider the effect of events subsequent to the balance-sheet date. The practitioner's consideration of such events in a review of MD&A is similar to the practitioner's consideration in an examination. (See paragraphs .65–.66.)

f. Obtain written representations from management concerning its responsibility for MD&A, completeness of minutes, events subsequent to the balance-sheet date, and other matters about which the practitioner believes written representations are appropriate. (See paragraph .110.)

g. Form a conclusion as to whether any information came to the practitioner's attention that causes him or her to believe any of the following.

   (1) The MD&A presentation does not include, in all material respects, the required elements of the rules and regulations adopted by the SEC.

   (2) The historical financial amounts included therein have not been accurately derived, in all material respects, from the entity's financial statements.

   (3) The underlying information, determinations, estimates, and assumptions of the entity do not provide a reasonable basis for the disclosures contained therein.

Planning the Engagement

.77 Planning an engagement to review MD&A involves developing an overall strategy for the analytical procedures and inquiries to be performed. When developing an overall strategy for the review engagement, the practitioner should consider factors such as the following:

- Matters affecting the industry in which the entity operates, such as financial reporting practices, economic conditions, laws and regulations, and technological changes
- Matters relating to the entity's business, including its organization, operating characteristics, capital structure, and distribution methods
- The types of relevant information that management reports to external analysts (for example, press releases or presentations to lenders and rating agencies concerning past and future performance)
- The extent of management's knowledge of and experience with the rules and regulations adopted by the SEC for MD&A
- If the entity is a nonpublic entity, the intended use of the MD&A presentation
- Matters identified during the audit or review of the historical financial statements relating to MD&A reporting, including knowledge of the entity's internal control applicable to the preparation of MD&A and the extent of recent changes, if any
- Matters identified during prior engagements to examine or review MD&A
- Preliminary judgments about materiality
- The nature of complex or subjective matters potentially material to the MD&A that may require special skill or knowledge
- The presence of an internal audit function and the extent to which internal auditors are involved in directly testing the MD&A presentation or underlying records

Consideration of Internal Control Applicable to the Preparation of MD&A

.78 To perform a review of MD&A, the practitioner needs to have sufficient knowledge of the entity's internal control applicable to the preparation of MD&A to—

- Identify types of potential misstatements in MD&A, including types of material omissions, and consider the likelihood of their occurrence.
- Select the inquiries and analytical procedures that will provide a basis for reporting whether any information causes the practitioner to believe the following.
  - — The MD&A presentation does not include, in all material respects, the required elements of the rules and regulations adopted by the SEC, or the historical financial amounts included therein have not been accurately derived, in all material respects, from the entity's financial statements.
  - — The underlying information, determinations, estimates, and assumptions of the entity do not provide a reasonable basis for the disclosures contained therein.

Application of Analytical Procedures and Inquiries

.79 The practitioner ordinarily would not obtain corroborating evidential matter of management's responses to the practitioner's inquiries in performing a review of MD&A. The practitioner should, however, consider the consistency of management's responses in light of the results of other inquiries and the application of analytical procedures. The practitioner ordinarily should apply the following analytical procedures and inquiries.

a. Read the MD&A presentation and compare the content for consistency with the audited financial statements (or reviewed interim financial information if MD&A includes interim information); compare financial amounts to the audited or reviewed financial statements or related accounting records and analyses; recompute the increases, decreases, and percentages disclosed.

b. Compare nonfinancial amounts to the audited (or reviewed) financial statements, if applicable, or to other records. (Refer to paragraph .80.)

c. Consider whether the explanations in MD&A are consistent with the information obtained during the audit or the review of interim financial information; make further inquiries of officers and other executives having responsibility for operational areas as necessary.

d. Obtain available prospective financial information (for example, budgets; sales forecasts; forecasts of labor, overhead, and materials costs; capital expenditure requests; and financial forecasts and projections) and compare such information to forward-looking MD&A disclosures. Inquire of management as to the procedures used to prepare the prospective financial information. Consider whether information came to the practitioner's attention that causes him or her to believe that the underlying information, determinations, estimates, and assumptions of the entity do not provide a reasonable basis for the disclosures of trends, demands, commitments, events, or uncertainties.[26]

e. Make inquiries of officers and other executives having responsibility for operational areas (such as sales, marketing, and production) and financial and accounting matters, as to any plans and expectations for the future that could affect the entity's liquidity and capital resources.

f. Compare the information in MD&A with the rules and regulations adopted by the SEC and consider whether the presentation includes the required elements of such rules and regulations.

g. Read the minutes of meetings to date of the board of directors and other significant committees to identify actions that may affect MD&A; consider whether such matters are appropriately addressed in the MD&A presentation.

h. Inquire of officers as to the entity's prior experience with the SEC and the extent of comments received upon review of documents by the SEC; read correspondence between the entity and the SEC with respect to such review, if any.

i. Inquire of management regarding the nature of public communications (for example, press releases and quarterly reports) dealing with historical and future results and consider whether the MD&A presentation is consistent with such communications.

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[26] Refer to paragraph .26 for a discussion concerning the safe harbor rules for forward-looking statements.

.80 If nonfinancial data are included in the MD&A presentation, the practitioner should inquire as to the nature of the records from which such information was derived and observe the existence of such records, but need not perform other tests of such records beyond analytical procedures and inquiries of individuals responsible for maintaining them. The practitioner should consider whether such nonfinancial data are relevant to users of the MD&A presentation and whether such data are clearly defined in the MD&A presentation. The practitioner should make inquiries regarding whether the definition of the nonfinancial data was consistently applied during the periods reported.

.81 However, if the practitioner becomes aware that the presentation may be incomplete or contain inaccuracies, or is otherwise unsatisfactory, the practitioner should perform the additional procedures he or she deems necessary to achieve the limited assurance contemplated by a review engagement.

Reporting

.82 In order for the practitioner to issue a report on a review of MD&A for an annual period, the financial statements for the periods covered by the MD&A presentation and the related auditor's report(s) should accompany the MD&A presentation (or with respect to a public entity be incorporated in the document containing the MD&A by reference to information filed with a regulatory agency).

.83 If the MD&A presentation relates to an interim period and the entity is a public entity, the financial statements for the interim periods covered by the MD&A presentation and the related accountant's review report(s) should accompany the MD&A presentation, or be incorporated in the document containing the MD&A by reference to information filed with a regulatory agency. The comparative financial statements for the most recent annual period and the related MD&A should accompany the MD&A presentation for the interim period, or be incorporated by reference to information filed with a regulatory agency. Generally, the requirement for inclusion of the annual financial statements and related MD&A is satisfied by a public entity that has met its reporting responsibility for filing its annual financial statements and MD&A in its annual report on Form 10-K.

.84 If the MD&A presentation relates to an interim period and the entity is a nonpublic entity, the following documents should accompany the interim MD&A presentation in order for the practitioner to issue a review report:

a. The MD&A presentation for the most recent fiscal year and related accountant's examination or review report(s)

b. The financial statements for the periods covered by the respective MD&A presentations (most recent fiscal year and interim periods and the related auditor's report(s) and accountant's review report(s))

In addition, one of the following conditions should be met.

- A statement should be included in the body of the MD&A presentation that it has been prepared using the rules and regulations adopted by the SEC.
- A separate written assertion should accompany the MD&A presentation or such assertion should be included in a representation letter obtained from the entity.

.85 The practitioner's report on a review of MD&A should include the following:

a. A title that includes the word *independent*

b. An identification of the MD&A presentation, including the period covered

c. A statement that management is responsible for the preparation of the MD&A pursuant to the rules and regulations adopted by the SEC

d. A reference to the auditor's report on the related financial statements, and, if the report was other than a standard report, the substantive reasons therefor

e. A statement that the review was conducted in accordance with attestation standards established by the AICPA

f. A description of the procedures for a review of MD&A

g. A statement that a review of MD&A is substantially less in scope than an examination, the objective of which is an expression of opinion regarding the MD&A presentation, and accordingly, no such opinion is expressed

h. A paragraph stating that—

(1) The preparation of MD&A requires management to interpret the criteria, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information

(2) Actual results in the future may differ materially from management's present assessment of information regarding the estimated future impact of transactions and events that have occurred or are expected to occur, expected sources of liquidity and capital resources, operating trends, commitments, and uncertainties

i. If the entity is a nonpublic entity, a statement that although the entity is not subject to the rules and regulations of the SEC, the MD&A presentation is intended to be a presentation in accordance with the rules and regulations adopted by the SEC

j. A statement about whether any information came to the practitioner's attention that caused him or her to believe that—

(1) The MD&A presentation does not include, in all material respects, the required elements of the rules and regulations adopted by the SEC

(2) The historical financial amounts included therein have not been accurately derived, in all material respects, from the entity's financial statements

(3) The underlying information, determinations, estimates, and assumptions of the entity do not provide a reasonable basis for the disclosures contained therein

k. If the entity is a public entity as defined in paragraph .02, or a nonpublic entity that is making or has made an offering of securities and it appears that the securities may subsequently be registered or subject to a filing with the SEC or other regulatory agency (for example, certain offerings of securities under Rule 144A of the 1933 Act that purport to conform to Regulation S-K), a statement of restrictions on the use of the report to specified parties, because it is not intended to be filed with the SEC as a report under the 1933 Act or the 1934 Act.

l. The manual or printed signature of the practitioner's firm

m. The date of the review report

Appendix B [paragraph .115], "Review Reports," provides examples of a standard review report for an annual and interim period.

Dating

.86 The practitioner's report on the review of MD&A should be dated as of the completion of the practitioner's review procedures. That date should not precede the date of the accountant's report on the latest historical financial statements covered by the MD&A.

Report Modifications

.87 The practitioner should modify the standard review report described in paragraph .86 if any of the following conditions exist.

- The presentation excludes a material required element of the rules and regulations adopted by the SEC. (See paragraph .89.)
- The historical financial amounts have not been accurately derived, in all material respects, from the entity's financial statements. (See paragraph .89.)
- The underlying information, determinations, estimates, and assumptions used by management do not provide the entity with a reasonable basis for the disclosures in the MD&A. (See paragraph .89.)
- The practitioner decides to refer to the report of another practitioner as the basis, in part, for his or her report. (See paragraph .90.)
- The practitioner is engaged to review the MD&A presentation after it has been filed with the SEC or other regulatory agency. (See paragraphs .94–.98.)

.88 When the practitioner is unable to perform the inquiry and analytical procedures he or she considers necessary to achieve the limited assurance provided by a review, or the client does not provide the practitioner with a representation letter, the review will be incomplete. A review that is incomplete is not an adequate basis for issuing a review report. If the practitioner is unable to complete a review because of a scope limitation, the practitioner should consider the implications of that limitation with respect to possible misstatements of the MD&A presentation. In those circumstances, the practitioner should also refer to paragraphs .107–.109 for guidance concerning communications with the audit committee.

.89 If the practitioner becomes aware that the MD&A is materially misstated, the practitioner should modify the review report to describe the nature of the misstatement. Appendix B [paragraph .115] contains an example of such a modification of the accountant's report. (See Example 3.)

.90 If another practitioner reviewed or examined the MD&A for a material component, the practitioner may decide to make reference to such report of the other practitioner in reporting on the consolidated MD&A presentation. Such reference indicates a division of responsibility for performance of the review.

Emphasis of a Matter

.91 In some circumstances, the practitioner may wish to emphasize a matter regarding the MD&A presentation. For example, he or she may wish to emphasize that the entity has included information beyond the required elements of the rules and regulations adopted by the SEC. Such explanatory comments should be presented in a separate paragraph of the practitioner's report.

Combined Examination and Review Report on MD&A

.92 A practitioner may be engaged both to examine an MD&A presentation as of the most recent fiscal year-end and to review a separate MD&A presentation for a subsequent interim period. If the examination and review are completed at the same time, a combined report may be issued. Appendix C [paragraph .116], "Combined Reports," contains an example of a combined report on an examination of an annual MD&A presentation and the review of a separate MD&A presentation for an interim period. (See Example 1.)

.93 If an entity prepares a combined MD&A presentation for annual and interim periods in which there is a discussion of liquidity and capital resources only as of the most recent interim period but not as of the most recent annual period, the practitioner is limited to performing the highest level of service that is provided with respect to the historical financial statements for any of the periods covered by the MD&A presentation. For example, if the annual financial statements have been audited and the interim financial statements have been reviewed, the practitioner may be engaged to perform a review of the combined MD&A presentation. Appendix C [paragraph .116] contains an example of a review report on a combined MD&A presentation for annual and interim periods. (See Example 2.)

When Practitioner Is Engaged Subsequent to the Filing of MD&A

.94 Management's responsibility for updating an MD&A presentation for events occurring subsequent to the issuance of MD&A depends on whether the entity is a public or nonpublic entity. A public entity is required to report significant subsequent events in a Form 8-K or Form 10-Q, or in a registration statement; therefore, a public company would ordinarily not modify its MD&A presentation once it is filed with the SEC (or other regulatory agency).

.95 Therefore, if the practitioner is engaged to examine (or review) an MD&A presentation of a public entity that has already been filed with the SEC (or other regulatory agency), the practitioner should consider whether material subsequent events are appropriately disclosed in a Form 8-K or 10-Q, or a registration statement that includes or incorporates by reference such MD&A presentation. Refer to paragraphs .65–.66 for guidance concerning consideration of events up to the filing date when the practitioner's report on MD&A will be included (or incorporated by reference) in a 1933 Act document filed with the SEC that will require a consent.

.96 If subsequent events of a public entity are appropriately disclosed in a Form 8-K or 10-Q, or in a registration statement, or if there have been no material subsequent events, the practitioner should add the following paragraph to his or her examination or review report following the opinion or concluding paragraph, respectively.

> The accompanying Management's Discussion and Analysis does not consider events that have occurred subsequent to Month XX, 20X6, the date as of which it was filed with the Securities and Exchange Commission.

.97 If there has been a material subsequent event that has not been disclosed in a manner described in paragraph .95 and if the practitioner determines that it is appropriate to issue a report even though the MD&A presentation has not been updated for such material subsequent event (for example, because the filing of the Form 10-Q that will disclose such events has not yet occurred), the practitioner should express a qualified or an adverse opinion (or appropriately modify the review report) on the MD&A presentation. As discussed in paragraph .107, if such material subsequent event is not appropriately disclosed, the practitioner should evaluate (*a*) whether to resign from the engagement related to the MD&A presentation and (*b*) whether to remain as the entity's auditor or stand for re-election to audit the entity's financial statements.

.98 Because a nonpublic entity is not subject to the filing requirements of the SEC, an MD&A presentation of a nonpublic entity should be updated for material subsequent events through the date of the practitioner's report.

When a Predecessor Auditor Has Audited Prior Period Financial Statements

.99 If a predecessor auditor has audited the financial statements for a prior period covered by the MD&A, the need by the practitioner reporting on the MD&A for an understanding of the business and the entity's accounting and financial reporting practices for such prior period, as discussed in paragraph .07, is not diminished and the practitioner should apply the appropriate procedures. In applying the appropriate procedures, the practitioner may consider reviewing the predecessor auditor's working papers with respect to audits of financial statements and examinations or reviews of MD&A presentations for such prior periods.

.100 Information that may be obtained from the audit or attest working papers of the predecessor auditor will not provide a sufficient basis in itself for the practitioner to express an opinion with respect to the MD&A disclosures for such prior periods. If the practitioner has audited the current year, the results of such audit may be considered in planning and performing the examination of MD&A and may provide evidential matter that is useful in performing the examination, including with respect to matters disclosed for prior periods. For example, an increase in salaries expense may be the result of an acquisition in the last half of the prior year. Auditing procedures applied to payroll expense in the current year that validate the increase as a result of the acquisition may provide evidential matter with respect to the increase in salaries expense in the prior year attributed to the acquisition.

.101 In addition to the procedures described in paragraphs .49–.66, the practitioner will need to make inquiries of the predecessor auditor and management as to audit adjustments proposed by the predecessor auditor that were not recorded in the financial statements.

Communications Between Predecessor and Successor Auditors

.102 If the practitioner is appointed as the successor auditor, he or she follows the guidance AU-C section 210, *Terms of Engagement*, in considering whether or not to accept the engagement. If, at the time of the appointment as auditor, the practitioner is also being engaged to examine or review MD&A, the practitioner should also make specific inquiries of the predecessor auditor regarding MD&A. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.103 The practitioner's examination may be facilitated by (*a*) making specific inquiries of the predecessor regarding matters that the successor believes may affect the conduct of the examination (or review), such as areas that required an inordinate amount of time or problems that arose from the condition of the records, and (*b*) if the predecessor previously examined or reviewed MD&A, reviewing the predecessor's working papers for the predecessor's examination or review engagement.

.104 If, subsequent to his or her engagement to audit the financial statements, the practitioner is requested to examine MD&A, the practitioner should request the client to authorize the predecessor auditor to allow a review of the predecessor's audit working papers related to the financial statement periods included in the MD&A presentation. Although the practitioner may previously have had access to the predecessor auditor's working papers in connection with the successor's audit of the financial statements, ordinarily the predecessor auditor should permit the practitioner to review those audit working papers relating to matters that are disclosed or that would likely be disclosed in MD&A.

Another Auditor Audits a Significant Part of the Financial Statements

.105 When one or more component auditors audits a significant part of a group's financial statements, the practitioner[27] may request that the component auditor perform procedures with respect to the MD&A or the practitioner may perform the procedures directly with respect to such component(s).[28] Unless the component auditor issues an examination or review report on a separate MD&A presentation of such component(s) (see paragraph .74), the practitioner examining the group's MD&A should not make reference to the work of the component practitioner on MD&A in his or her report on MD&A[29] Accordingly, if the practitioner examining the group's MD&A has requested such component auditor to perform procedures, the practitioner examining the group's MD&A should perform those procedures that he or she considers necessary to take responsibility for the work of the other auditor. Such procedures may include one or more of the following:

a. Visiting the component auditor and discussing the procedures followed and the results thereof.

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[27] The practitioner serving as auditor of the group's financial statements is presumed to have an audit base for purposes of examining or reviewing the consolidated MD&A presentation. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

[28] The practitioner should consider whether he or she has sufficient industry expertise with respect to a subsidiary audited by a component auditor to take sole responsibility for the group's consolidated MD&A presentation. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

[29] This does not preclude the practitioner from referring to the component auditor's report on the financial statements in his or her report on the group's MD&A. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

b. Reviewing the working papers of the component auditor with respect to the component.

c. Participating in discussions with the component's management regarding matters that may affect the preparation of the component's MD&A.

d. Making supplemental tests with respect to such component.

The determination of the extent of the procedures to be applied by the practitioner examining the group's MD&A rests with that practitioner alone in the exercise of his or her professional judgment and in no way constitutes a reflection on the adequacy of the component auditor's work. Because the practitioner examining the group's MD&A in this case assumes responsibility for his or her opinion on the MD&A presentation without making reference to the procedures performed by the other auditor, the judgment of the practitioner examining the group's MD&A should govern as to the extent of procedures to be undertaken. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Responsibility for Other Information in Documents Containing MD&A

.106 A client may publish annual reports containing MD&A and other documents to which the practitioner, at the client's request, devotes attention. See paragraphs .91–.94 of section 101 for pertinent guidance in these circumstances. See Appendix D of this section [paragraph .117], "Comparison of Activities Performed Under SAS No. 8, *Other Information in Documents Containing Audited Financial Statements*, Versus a Review or an Examination Attest Engagement." The guidance in AU-C section 925, *Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933*, is pertinent when the practitioner's report on MD&A is included in a registration statement, proxy statement, or periodic report filed under the federal securities statutes. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Communications With the Audit Committee

.107 If the practitioner concludes that the MD&A presentation contains material inconsistencies with other information included in the document containing the MD&A presentation or with the historical financial statements,[30] material omissions, or material misstatements of fact, and management refuses to take corrective action, the practitioner should inform the audit committee or others with equivalent authority and responsibility. If the MD&A is not revised, the practitioner should evaluate (*a*) whether to resign from the engagement related to the MD&A, and (*b*) whether to remain as the entity's auditor or stand for re-election to audit the entity's financial statements. The practitioner may wish to consult with his or her attorney when making these evaluations.

.108 If the practitioner is engaged after the MD&A presentation has been filed with the SEC (or other regulatory agency), and becomes aware that such MD&A presentation on file with the SEC (or other regulatory agency) has not been revised for a matter for which the practitioner has or would qualify his or her opinion, the practitioner should discuss such matter with the audit commit-

[30] See AU-C section 720, *Information in Documents Containing Audited Financial Statements*, for guidance on the impact of material inconsistencies or material misstatements of fact on the auditor's report on the related historical financial statements. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

tee and request that the MD&A presentation be revised. If the audit committee fails to take appropriate action, the practitioner should consider whether to resign as the independent auditor of the company. The practitioner may consider paragraphs .21–.23 and .27 of AU-C section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*, concerning communication with the audit committee and other considerations. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.109 If, as a result of performing an examination or a review of MD&A, the practitioner has determined that there is evidence that fraud may exist, that matter should be brought to the attention of an appropriate level of management. This is generally appropriate even if the matter might be considered clearly inconsequential. If the matter relates to the audited financial statements, the practitioner should consider the guidance in AU-C section 240, *Consideration of Fraud in a Financial Statement Audit*, concerning communication responsibilities, and the effect on the auditor's report on the financial statements. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Obtaining Written Representations

.110 In an examination or a review engagement, the practitioner should obtain written representations from management.[31] The specific written representations obtained by the practitioner will depend on the circumstances of the engagement and the nature of the MD&A presentation. Specific representations should relate to the following matters:

a. Management's acknowledgment of its responsibility for the preparation of MD&A and management's assertion that the MD&A presentation has been prepared in accordance with the rules and regulations adopted by the SEC for MD&A[32]

b. A statement that the historical financial amounts included in MD&A have been accurately derived from the entity's financial statements

c. Management's belief that the underlying information, determinations, estimates, and assumptions of the entity provide a reasonable basis for the disclosures contained in the MD&A

d. A statement that management has made available all significant documentation related to compliance with SEC rules and regulations for MD&A

e. Completeness and availability of all minutes of meetings of stockholders, directors, and committees of directors

f. For a public entity, whether any communications from the SEC were received concerning noncompliance with or deficiencies in MD&A reporting practices

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[31] Paragraph .21 of AU-C section 580, *Written Representations*, requires that written representations be in the form of a representation letter addressed to the auditor. Paragraph .09*b* of AU-C section 925 requires the auditor to obtain updated written representations from management at or shortly before the effective date of the registration statement, about (*a*) whether any information has come to management's attention that would cause management to believe that any of the previous representations should be modified, and (*b*) whether any events have occurred subsequent to the date of the financial statements that would require adjustment to, or disclosure in, those financial statements. (See paragraph .65.) [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

[32] Management should specify the SEC rules (for example, Item 303 of Regulation S-K, Item 303 of Regulation S-B, or Item 9 of Form 20-F). For nonpublic entities, the practitioner also obtains a written assertion that the presentation has been prepared using the rules and regulations adopted by the SEC. (See paragraph .02.)

g. Whether any events occurred subsequent to the latest balance-sheet date that would require disclosure in the MD&A

h. If forward-looking information is included, a statement that—

- The forward-looking information is based on management's best estimate of expected events and operations, and is consistent with budgets, forecasts, or operating plans prepared for such periods
- The accounting principles expected to be used for the forward-looking information are consistent with the principles used in preparing the historical financial statements
- Management has provided the latest version of such budgets, forecasts, or operating plans, and has informed the practitioner of any anticipated changes or modifications to such information that could affect the disclosures contained in the MD&A presentation

i. If voluntary information is included that is subject to the rules and regulations adopted by the SEC (for example, information required by Item 305, *Quantitative and Qualitative Disclosures About Market Risk*), a statement that such voluntary information has been prepared in accordance with the related rules and regulations adopted by the SEC for such information

j. If pro forma information is included, a statement that—

- Management is responsible for the assumptions used in determining the pro forma adjustments
- Management believes that the assumptions provide a reasonable basis for presenting all the significant effects directly attributable to the transaction or event, that the related pro forma adjustments give appropriate effect to those assumptions, and that the pro forma column reflects the proper application of those adjustments to the historical financial statements
- Management believes that the significant effects directly attributable to the transaction or event are appropriately disclosed in the pro forma financial information

.111 In an examination, management's refusal to furnish written representations constitutes a limitation on the scope of the engagement sufficient to preclude an unqualified opinion and is ordinarily sufficient to cause a practitioner to disclaim an opinion or withdraw from the examination engagement. However, based on the nature of the representations not obtained or the circumstances of the refusal, the practitioner may conclude that a qualified opinion is appropriate in an examination engagement. In a review engagement, management's refusal to furnish written representations constitutes a limitation of the scope of the engagement sufficient to require withdrawal from the review engagement. Further, the practitioner should consider the effects of the refusal on his or her ability to rely on other management representations.

.112 If the practitioner is precluded from performing procedures he or she considers necessary in the circumstances with respect to a matter that is material to the MD&A presentation, even though management has given representations concerning the matter, there is a limitation on the scope of the engagement, and the practitioner should qualify his or her opinion or disclaim an opinion in an examination engagement, or withdraw from a review engagement.

Effective Date

.113 This section is effective when management's discussion and analysis is for a period ending on or after June 1, 2001. Early application is permitted.

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Appendix A

Examination Reports

Example 1: Standard Examination Report

1. The following is an illustration of a standard examination report.

Independent Accountant's Report

[*Introductory paragraph*]

We have examined XYZ Company's Management's Discussion and Analysis taken as a whole, included [*incorporated by reference*] in the Company's [*insert description of registration statement or document*]. Management is responsible for the preparation of the Company's Management's Discussion and Analysis pursuant to the rules and regulations adopted by the Securities and Exchange Commission. Our responsibility is to express an opinion on the presentation based on our examination. We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X5 and 20X4, and the related statements of income, changes in stockholder's equity, and cash flows for each of the years in the three-year period ended December 31, 20X5, and the related notes to the financial statements. In our report dated [*Month*] XX, 20X6, we expressed an unmodified opinion on those financial statements.[33]

[*Scope paragraph*]

Our examination of Management's Discussion and Analysis was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence supporting the historical amounts and disclosures in the presentation. An examination also includes assessing the significant determinations made by management as to the relevancy of information to be included and the estimates and assumptions that affect reported information. We believe that our examination provides a reasonable basis for our opinion.

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[33] If prior financial statements were audited by other auditors, this sentence would be replaced by the following.

> We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of XYZ Company, which comprise the balance sheet as of December 31, 20X5, and the related statement of income, changes in stockholder's equity, and cash flows for the year then ended, and the related notes to the financial statements. In our report dated [*Month*] XX, 20X6, we expressed an unmodified opinion on those financial statements. The financial statements of XYZ Company; which comprise the balance sheet as of December 31, 20X4, and the related statement of income, changes in stockholder's equity, and cash flows for each of the years in the two-year period then ended, and the notes to the financial statements; were audited by other auditors, whose report dated [*Month*] XX, 20X5, expressed an unmodified opinion on those financial statements.

If the practitioner's opinion on the financial statements is based on the report of component auditors, this sentence would be replaced by the following:

> We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of XYZ Company which comprise the balance sheets as of December 31, 20X5 and 20X4, and the related statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 20X5, and the notes to the financial statements. In our report dated [*Month*] XX, 20X6, we expressed an unmodified opinion on those financial statements based on our audits and the report of component auditors.

Refer to Example 3 if the practitioner's opinion on MD&A is based on the report of another practitioner on a component of the entity. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

[*Explanatory paragraph*][34]

The preparation of Management's Discussion and Analysis requires management to interpret the criteria, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information. Management's Discussion and Analysis includes information regarding the estimated future impact of transactions and events that have occurred or are expected to occur, expected sources of liquidity and capital resources, operating trends, commitments, and uncertainties. Actual results in the future may differ materially from management's present assessment of this information because events and circumstances frequently do not occur as expected.

[*Opinion paragraph*]

In our opinion, the Company's presentation of Management's Discussion and Analysis includes, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission; the historical financial amounts included therein have been accurately derived, in all material respects, from the Company's financial statements; and the underlying information, determinations, estimates, and assumptions of the Company provide a reasonable basis for the disclosures contained therein.

[*Signature*]

[*Date*]

Example 2: Modifications to Examination Report for a Qualified Opinion

2. An example of a modification of an examination report for a qualified opinion due to a material omission described in paragraph .72 follows.

[*Additional explanatory paragraph preceding the opinion paragraph*]

Based on information furnished to us by management, we believe that the Company has excluded a discussion of the significant capital outlay required for its plans to expand into the telecommunications industry and the possible effects on the Company's financial condition, liquidity, and capital resources.

[*Opinion paragraph*]

In our opinion, except for the omission of the matter described in the preceding paragraph, the Company's presentation of Management's Discussion and Analysis includes, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission; the historical financial amounts included therein have been accurately derived, in all material respects, from the Company's financial statements; and the underlying information, determinations, estimates, and assumptions of the Company provide a reasonable basis for the disclosures contained therein.

3. An example of a modification of an examination report for a qualified opinion when overly subjective assertions are included in MD&A follows.

[*Additional explanatory paragraph preceding the opinion paragraph*]

Based on information furnished to us by management, we believe that the underlying information, determinations, estimates, and assumptions used by

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[34] The following sentence should be added to the beginning of the explanatory paragraph if the entity is a nonpublic entity, as discussed in paragraph .69*h*:

Although XYZ Company is not subject to the rules and regulations of the Securities and Exchange Commission, the accompanying Management's Discussion and Analysis is intended to be a presentation in accordance with the rules and regulations adopted by the Securities and Exchange Commission.

management do not provide the Company with a reasonable basis for the disclosure concerning [*describe*] in the Company's Management's Discussion and Analysis.

[*Opinion paragraph*]

In our opinion, except for the disclosure regarding [*describe*] discussed in the preceding paragraph, the Company's presentation of Management's Discussion and Analysis includes, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission; the historical financial amounts included therein have been accurately derived, in all material respects, from the Company's financial statements; and the underlying information, determinations, estimates, and assumptions of the Company provide a reasonable basis for the disclosures contained therein.

Example 3: Examination Report With Reference to the Report of Another Practitioner

4. The following is an illustration of an examination report indicating a division of responsibility with another practitioner, who has examined a separate MD&A presentation of a wholly-owned subsidiary, when the practitioner reporting is serving as the auditor of the related group's consolidated financial statements.

Independent Accountant's Report

[*Introductory paragraphs*]

We have examined XYZ Company's Management's Discussion and Analysis taken as a whole, included [*incorporated by reference*] in the Company's [*insert description of registration statement or document*]. Management is responsible for the preparation of the Company's Management's Discussion and Analysis pursuant to the rules and regulations adopted by the Securities and Exchange Commission. Our responsibility is to express an opinion on the presentation based on our examination. We did not examine Management's Discussion and Analysis of ABC Corporation, a wholly-owned subsidiary, included in ABC Corporation's [*insert description of registration statement or document*]. Such Management's Discussion and Analysis was examined by other accountants, whose report has been furnished to us, and our opinion, insofar as it relates to information included for ABC Corporation, is based solely on the report of the other accountants.

We have audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated financial statements of XYZ Company, which comprise the consolidated balance sheets as of December 31, 20X5 and 20X4, and the related consolidated statements of income, changes in stockholders' equity, and cash flows, for each of the years in the three-year period ended December 31, 20X5. In our report dated [*Month*] XX, 20X6, we expressed an unmodified opinion on those financial statements based on our audits and the report of other auditors.

[*Scope paragraph*]

Our examination of Management's Discussion and Analysis was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence supporting the historical amounts and disclosures in the presentation. An examination also includes assessing the significant determinations made by management as to the relevancy of information to be included and the estimates and assumptions that affect reported information. We believe that our examination and the report of other accountants provide a reasonable basis for our opinion.

[*Explanatory paragraph*][35]

The preparation of Management's Discussion and Analysis requires management to interpret the criteria, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information. Management's Discussion and Analysis includes information regarding the estimated future impact of transactions and events that have occurred or are expected to occur, expected sources of liquidity and capital resources, operating trends, commitments, and uncertainties. Actual results in the future may differ materially from management's present assessment of this information because events and circumstances frequently do not occur as expected.

[*Opinion paragraph*]

In our opinion, based on our examination and the report of other accountants, the Company's presentation of Management's Discussion and Analysis included [*incorporated by reference*] in the Company's [*insert description of registration statement or document*] includes, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission; the historical financial amounts included therein have been accurately derived, in all material respects, from the Company's financial statements; and the underlying information, determinations, estimates, and assumptions of the Company provide a reasonable basis for the disclosures contained therein.

[*Signature*]

[*Date*]

[Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

[35] The following sentence should be added to the beginning of the explanatory paragraph if the entity is a nonpublic entity, as discussed in paragraph .69*h*.

Although XYZ Company is not subject to the rules and regulations of the Securities and Exchange Commission, the accompanying Management's Discussion and Analysis is intended to be a presentation in accordance with the rules and regulations adopted by the Securities and Exchange Commission.

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Appendix B

Review Reports

Example 1: Standard Review Report on an Annual MD&A Presentation

1. The following is an illustration of a standard review report on an annual MD&A presentation.

Independent Accountant's Report

[*Introductory paragraph*]

We have reviewed XYZ Company's Management's Discussion and Analysis taken as a whole, included [*incorporated by reference*] in the Company's [*insert description of registration statement or document*]. Management is responsible for the preparation of the Company's Management's Discussion and Analysis pursuant to the rules and regulations adopted by the Securities and Exchange Commission. We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X5 and 20X4, and the related statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 20X5. In our report dated [*Month*] XX, 20X6, we expressed an unqualified opinion on those financial statements.

[*Scope paragraph*]

We conducted our review of Management's Discussion and Analysis in accordance with attestation standards established by the American Institute of Certified Public Accountants. A review of Management's Discussion and Analysis consists principally of applying analytical procedures and making inquiries of persons responsible for financial, accounting, and operational matters. It is substantially less in scope than an examination, the objective of which is the expression of an opinion on the presentation. Accordingly, we do not express such an opinion.

[*Explanatory paragraph*][36]

The preparation of Management's Discussion and Analysis requires management to interpret the criteria, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information. Management's Discussion and Analysis includes information regarding the estimated future impact of transactions and events that have occurred or are expected to occur, expected sources of liquidity and capital resources, operating trends, commitments, and uncertainties. Actual results in the future may differ materially from management's present assessment of this information because events and circumstances frequently do not occur as expected.

[*Concluding paragraph*]

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[36] The following sentence should be added to the beginning of the explanatory paragraph if the entity is a nonpublic entity, as discussed in paragraph .85*i*.

Although XYZ Company is not subject to the rules and regulations of the Securities and Exchange Commission, the accompanying Management's Discussion and Analysis is intended to be a presentation in accordance with the rules and regulations adopted by the Securities and Exchange Commission.

Based on our review, nothing came to our attention that caused us to believe that the Company's presentation of Management's Discussion and Analysis does not include, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission, that the historical financial amounts included therein have not been accurately derived, in all material respects, from the Company's financial statements, or that the underlying information, determinations, estimates and assumptions of the Company do not provide a reasonable basis for the disclosures contained therein.

[*Restricted use paragraph*][37]

This report is intended solely for the information and use of [*list or refer to specified parties*] and is not intended to be and should not be used by anyone other than the specified parties.

[*Signature*]

[*Date*]

Example 2: Standard Review Report on an Interim MD&A Presentation

2. The following is an illustration of a standard review report on an MD&A presentation for an interim period.

Independent Accountant's Report

[*Introductory paragraph*]

We have reviewed XYZ Company's Management's Discussion and Analysis taken as a whole included in the Company's [*insert description of registration statement or document*]. Management is responsible for the preparation of the Company's Management's Discussion and Analysis pursuant to the rules and regulations adopted by the Securities and Exchange Commission. We have reviewed, in accordance with standards established by the American Institute of Certified Public Accountants, the interim financial information of XYZ Company as of June 30, 20X6 and 20X5, and for the three-month and six-month periods then ended, and have issued our report thereon dated July XX, 20X6.

[*Scope paragraph*]

We conducted our review of Management's Discussion and Analysis in accordance with attestation standards established by the American Institute of Certified Public Accountants. A review of Management's Discussion and Analysis consists principally of applying analytical procedures and making inquiries of persons responsible for financial, accounting, and operational matters. It is substantially less in scope than an examination, the objective of which is the expression of an opinion on the presentation. Accordingly, we do not express such an opinion.

[*Explanatory paragraph*][38]

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[37] This paragraph may be omitted for certain nonpublic entities. (Refer to paragraph .85*k*.)

[38] The following sentence should be added to the beginning of the explanatory paragraph if the entity is a nonpublic entity, as discussed in paragraph .85*i*.

Although XYZ Company is not subject to the rules and regulations of the Securities and Exchange Commission, the accompanying Management's Discussion and Analysis is intended to be a presentation in accordance with the rules and regulations adopted by the Securities and Exchange Commission.

The preparation of Management's Discussion and Analysis requires management to interpret the criteria, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information. Management's Discussion and Analysis includes information regarding the estimated future impact of transactions and events that have occurred or are expected to occur, expected sources of liquidity and capital resources, operating trends, commitments, and uncertainties. Actual results in the future may differ materially from management's present assessment of this information because events and circumstances frequently do not occur as expected.

[*Concluding paragraph*]

Based on our review, nothing came to our attention that caused us to believe that the Company's presentation of Management's Discussion and Analysis does not include, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission, that the historical financial amounts included therein have not been accurately derived, in all material respects, from the Company's financial statements, or that the underlying information, determinations, estimates, and assumptions of the Company do not provide a reasonable basis for the disclosures contained therein.

[*Restricted use paragraph*][39]

This report is intended solely for the information and use of [*list or refer to specified parties*] and is not intended to be and should not be used by anyone other than the specified parties.

[*Signature*]

[*Date*]

Example 3: Modification to Review Report for a Material Misstatement

3. An example of a modification of the accountant's report when MD&A is materially misstated, as discussed in paragraph .89, follows.

[*Additional explanatory paragraph preceding the concluding paragraph*]

Based on information furnished to us by management, we believe that the Company has excluded a discussion of the significant capital outlay required for its plans to expand into the telecommunications industry and the possible effects on the Company's financial condition, liquidity, and capital resources.

[*Concluding paragraph*]

Based on our review, with the exception of the matter described in the preceding paragraph, nothing came to our attention that caused us to believe that the Company's presentation of Management's Discussion and Analysis does not include, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission, that the historical financial amounts included therein have not been accurately derived, in all material respects, from the Company's financial statements, or that the underlying information, determinations, estimates and assumptions of the Company do not provide a reasonable basis for the disclosures contained therein.

[Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

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[39] This paragraph may be omitted for certain nonpublic entities. (Refer to paragraph .85*k*.)

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Appendix C

Combined Reports

Example 1: Combined Examination and Review Report on MD&A

1. An example of a combined report on an examination of an annual MD&A presentation and the review of MD&A for an interim period discussed in paragraph .92 follows.

Independent Accountant's Report

[*Introductory paragraph*]

We have examined XYZ Company's Management's Discussion and Analysis taken as a whole for the three-year period ended December 31, 20X5, included [*incorporated by reference*] in the Company's [*insert description of registration statement or document*]. Management is responsible for the preparation of the Company's Management's Discussion and Analysis pursuant to the rules and regulations adopted by the Securities and Exchange Commission. Our responsibility is to express an opinion on the annual presentation based on our examination. We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of XYZ Company as of December 31, 20X5 and 20X4, and for each of the years in the three-year period ended December 31, 19X5, and in our report dated [*Month*] XX, 20X6, we expressed an unqualified opinion on those financial statements.

[*Scope paragraph*]

Our examination of Management's Discussion and Analysis was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence supporting the historical amounts and disclosures in the presentation. An examination also includes assessing the significant determinations made by management as to the relevancy of information to be included and the estimates and assumptions that affect reported information. We believe that our examination provides a reasonable basis for our opinion.

[*Explanatory paragraph*][40]

The preparation of Management's Discussion and Analysis requires management to interpret the criteria, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information. Management's Discussion and Analysis includes information regarding the estimated future impact of transactions and events that have occurred or are expected to occur, expected sources of liquidity and capital resources, operating trends, commitments, and uncertainties. Actual results in

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[40] The following sentence should be added to the beginning of the explanatory paragraph if the entity is a nonpublic entity, as discussed in paragraph .69*h*.

Although XYZ Company is not subject to the rules and regulations of the Securities and Exchange Commission, the accompanying Management's Discussion and Analysis is intended to be a presentation in accordance with the rules and regulations adopted by the Securities and Exchange Commission.

the future may differ materially from management's present assessment of this information because events and circumstances frequently do not occur as expected.

[*Opinion paragraph*]

In our opinion, the Company's presentation of Management's Discussion and Analysis for the three-year period ended December 31, 20X5, includes, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission; the historical financial amounts included therein have been accurately derived, in all material respects, from the Company's financial statements; and the underlying information, determinations, estimates, and assumptions of the Company provide a reasonable basis for the disclosures contained therein.

[*Paragraphs on interims*]

We have also reviewed XYZ Company's Management's Discussion and Analysis taken as a whole for the six-month period ended June 30, 20X6 included [*incorporated by reference*] in the Company's [*insert description of registration statement or document*]. We have reviewed, in accordance with standards established by the American Institute of Certified Public Accountants, the interim financial information of XYZ Company as of June 30, 20X6 and 20X5, and for the six-month periods then ended, and have issued our report thereon dated July XX, 20X6.

We conducted our review of Management's Discussion and Analysis in accordance with attestation standards established by the American Institute of Certified Public Accountants. A review of Management's Discussion and Analysis consists principally of applying analytical procedures and making inquiries of persons responsible for financial, accounting, and operational matters. It is substantially less in scope than an examination, the objective of which is the expression of an opinion on the presentation. Accordingly, we do not express such an opinion.

Based on our review, nothing came to our attention that caused us to believe that the Company's presentation of Management's Discussion and Analysis for the six-month period ended June 30, 20X6, does not include, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission, that the historical financial amounts included therein have not been accurately derived, in all material respects, from the Company's unaudited interim financial statements, or that the underlying information, determinations, estimates, and assumptions of the Company do not provide a reasonable basis for the disclosures contained therein.

[*Restricted use paragraph*][41]

This report is intended solely for the information and use of [*list or refer to specified parties*] and is not intended to be and should not be used by anyone other than the specified parties.

[*Signature*]

[*Date*]

Example 2: Review Report on a Combined Annual and Interim MD&A Presentation

2. An example of a review report on a combined MD&A presentation for annual and interim periods follows.

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[41] This paragraph may be omitted for certain nonpublic entities. (Refer to paragraph .85*k*.)

<u>Independent Accountant's Report</u>

[*Introductory paragraph*]

We have reviewed XYZ Company's Management's Discussion and Analysis taken as a whole included [*incorporated by reference*] in the Company's [*insert description of registration statement or document*]. Management is responsible for the preparation of the Company's Management's Discussion and Analysis pursuant to the rules and regulations adopted by the Securities and Exchange Commission. We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of XYZ Company as of December 31, 20X5 and 20X4, and for each of the years in the three-year period ended December 31, 20X5, and in our report dated [*Month*] XX, 20X6, we expressed an unqualified opinion on those financial statements. We have reviewed, in accordance with standards established by the American Institute of Certified Public Accountants, the interim financial information of XYZ Company as of June 30, 20X6 and 20X5, and for the six-month periods then ended, and have issued our report thereon dated July XX, 20X6.

[*Scope paragraph*]

We conducted our review of Management's Discussion and Analysis in accordance with attestation standards established by the American Institute of Certified Public Accountants. A review of Management's Discussion and Analysis consists principally of applying analytical procedures and making inquiries of persons responsible for financial, accounting, and operational matters. It is substantially less in scope than an examination, the objective of which is the expression of an opinion on the presentation. Accordingly, we do not express such an opinion.

[*Explanatory paragraph*][42]

The preparation of Management's Discussion and Analysis requires management to interpret the criteria, make determinations as to the relevancy of information to be included, and make estimates and assumptions that affect reported information. Management's Discussion and Analysis includes information regarding the estimated future impact of transactions and events that have occurred or are expected to occur, expected sources of liquidity and capital resources, operating trends, commitments, and uncertainties. Actual results in the future may differ materially from management's present assessment of this information because events and circumstances frequently do not occur as expected.

[*Concluding paragraph*]

Based on our review, nothing came to our attention that caused us to believe that the Company's presentation of Management's Discussion and Analysis does not include, in all material respects, the required elements of the rules and regulations adopted by the Securities and Exchange Commission, that the historical financial amounts included therein have not been accurately derived, in all material respects, from the Company's financial statements, or that the underlying information, determinations, estimates, and assumptions of the Company do not provide a reasonable basis for the disclosures contained therein.

[*Restricted use paragraph*][43]

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[42] The following sentence should be added to the beginning of the explanatory paragraph if the entity is a nonpublic entity, as discussed in paragraph .69*h*.

Although XYZ Company is not subject to the rules and regulations of the Securities and Exchange Commission, the accompanying Management's Discussion and Analysis is intended to be a presentation in accordance with the rules and regulations adopted by the Securities and Exchange Commission.

[43] This paragraph may be omitted for certain nonpublic entities. (Refer to paragraph .85*k*.)

This report is intended solely for the information and use of [*list or refer to specified parties*] and is not intended to be and should not be used by anyone other than the specified parties.

[*Signature*]

[*Date*]

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Appendix D

Comparison of Activities Performed Under SAS No. 118, *Other Information in Documents Containing Audited Financial Statements* [AU-C Section 720], Versus a Review or an Examination Attest Engagement*

Activities	*SAS No. 118 (AU-C Section 720)*	*Review*	*Examination*
Obtain an understanding of SEC rules and regulations and management's methodology for the preparation of Management's Discussion and Analysis (MD&A).	Not applicable (N/A)—Auditor is only required to read the information in the MD&A in order to identify material inconsistencies, if any, with the audited financial statements.	Obtain an understanding of the rules and regulations adopted by the SEC for MD&A. Inquire of management regarding the method of preparing MD&A.	Same as for a review.
Plan the engagement.	N/A	Develop an overall strategy for the analytical procedures and inquiries to be performed to provide negative assurance.	Develop an overall strategy for the expected scope and performance of the engagement to obtain reasonable assurance to express an opinion.
Consider internal control.	N/A	Consider relevant portions of the entity's internal control applicable to the preparation of MD&A to identify the types of potential misstatements and to select the inquiries and analytical procedures; no testing of controls would be performed.	Obtain an understanding of internal control applicable to the preparation of MD&A sufficient to plan the engagement and to assess control risk; controls may be tested by performing inquiries of client personnel, inspection of documents, and observation of relevant activities.

* Refer to AU-C section 720, *Other Information in Documents Containing Audited Financial Statements*. [Footnote revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

(continued)

Activities	*SAS No. 118 (AU-C Section 720)*	*Review*	*Examination*
Test assertions.	N/A	Apply the following analytical procedures and make inquiries of management and others; no corroborating evidential matter is obtained: • Read the MD&A and compare the content for consistency with the financial statements; compare financial amounts to the financial statements or related accounting records and analyses; recompute increases, decreases and percentages disclosed. • Compare nonfinancial amounts to the financial statements or other records. • Consider whether MD&A explanations are consistent with information obtained during the audit or review of financial statements; make further inquiries, as necessary. (Note: Such additional inquiries may result in a decision to perform other procedures or detail tests.) • Compare information in MD&A with the rules and regulations adopted by the SEC. • Obtain and read available prospective financial information; inquire of management as to the procedures used to prepare such information; consider whether information came to the practitioner's attention that causes him or her to believe that the underlying information, determinations, estimates, and assumptions do not provide a reasonable basis for the MD&A disclosures.	Apply the following analytical and corroborative procedures to obtain reasonable assurance of detecting material misstatements: • Read the MD&A and compare the content for consistency with the financial statements; compare financial amounts to the financial statements or related accounting records and analyses; recompute increases, decreases and percentages disclosed. • Compare nonfinancial amounts to the financial statements or other records; perform tests on other records based on the concept of materiality. • Consider whether explanations are consistent with the information obtained during the audit of financial statements; investigate further explanations that cannot be substantiated by information in the audit working papers through inquiry and inspection of client records. • Examine internally and externally generated documents in support of the existence, occurrence, or expected occurrence of events, transactions, conditions, trends, demands, commitments, and uncertainties disclosed in MD&A. • Compare information in MD&A with the rules and regulations adopted by the SEC.

Activities	*SAS No. 118 (AU-C Section 720)*	*Review*	*Examination*
Test assertions. (*continued*)		• Obtain public communications and minutes of meetings for comparison with disclosures in MD&A. • Make inquiries of the officers or executives with responsibility for operational areas and financial and accounting matters as to their plans and expectations for the future. • Inquire as to prior experience with the SEC and the extent of comments received; read correspondence. • Consider whether there are any additional matters that should be disclosed in the MD&A based on the results of the preceding procedures and knowledge obtained during the audit or review of the financial statements.	• Obtain and read available prospective financial information; inquire of management as to the procedures used to prepare such information; evaluate whether the underlying information, determinations, estimates, and assumptions provide a reasonable basis for the MD&A disclosures. • Obtain public communications and minutes of meetings; consider obtaining other types of publicly available information for comparison with the disclosures in MD&A. • Make inquiries of the officers or executives with responsibility for operational areas and financial and accounting matters as to their plans and expectations for the future. • Inquire as to prior experience with the SEC and the extent of comments received; read correspondence. • Test completeness by considering the results of the preceding procedures and knowledge obtained during the audit of the financial statements, and whether such matters are appropriately disclosed in the MD&A; extend procedures if the inherent risk relating to completeness of disclosures is high.

(continued)

Activities	*SAS No. 118 (AU-C Section 720)*	*Review*	*Examination*
Consider the effect of events subsequent to the balance-sheet date.	Yes	Yes	Yes
Obtain written representations from management.	Yes	Yes	Yes
Form a conclusion and report.	The auditor has no reporting responsibility with respect to MD&A unless the auditor concludes that there is a material inconsistency in the MD&A that has not been eliminated. In such a situation, the auditor may add an other matter paragraph to the auditor's report on the audited financial statements describing the material inconsistency or withhold the auditor's report. If, while reading the MD&A, the auditor becomes aware of an apparent material misstatement of fact, the auditor should discuss such matter with management and take other actions based on management's response.	Form a conclusion based on the results of the preceding procedures and report in the form of negative assurance.	Form an opinion based on the results of the preceding procedures and report conclusion by expressing an opinion.

[Revised, December 2010, to reflect conforming changes necessary due to the issuance of SAS Nos. 118–120. Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

AT Section 801

Reporting on Controls at a Service Organization

(Supersedes the guidance for service auditors in Statement on Auditing Standards No. 70, Service Organizations, as amended.)

Source: SSAE No. 16.

Effective for service auditors' reports for periods ending on or after June 15, 2011. Earlier implementation is permitted.

Introduction

Scope of This Section

.01 This section addresses examination engagements undertaken by a service auditor to report on controls at organizations that provide services to user entities when those controls are likely to be relevant to user entities' internal control over financial reporting. It complements AU-C section 402, *Audit Considerations Relating to an Entity Using a Service Organization*, in that reports prepared in accordance with this section may provide appropriate evidence under AU-C section 402. (Ref: par. .A1) [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.02 The focus of this section is on controls at service organizations likely to be relevant to user entities' internal control over financial reporting. The guidance herein also may be helpful to a practitioner performing an engagement under section 101, *Attest Engagements*, to report on controls at a service organization

a. other than those that are likely to be relevant to user entities' internal control over financial reporting (for example, controls that affect user entities' compliance with specified requirements of laws, regulations, rules, contracts, or grants, or controls that affect user entities' production or quality control). Section 601, *Compliance Attestation*, is applicable if a practitioner is reporting on an entity's own compliance with specified requirements or on its controls over compliance with specified requirements. (Ref: par. .A2–.A3)

b. when management of the service organization is not responsible for the design of the system (for example, when the system has been designed by the user entity or the design is stipulated in a contract between the user entity and the service organization). (Ref: par. .A4)

.03 In addition to performing an examination of a service organization's controls, a service auditor may be engaged to (*a*) examine and report on a user entity's transactions or balances maintained by a service organization, or (*b*) perform and report the results of agreed upon procedures related to the controls of a service organization or to transactions or balances of a user entity maintained by a service organization. However, these engagements are not addressed in this section.

.04 The requirements and application material in this section are based on the premise that management of the service organization (also referred to as management) will provide the service auditor with a written assertion that is included in or attached to management's description of the service organization's system. Paragraph .10 of this section addresses the circumstance in which management refuses to provide such a written assertion. Section 101 indicates that when performing an attestation engagement, a practitioner may report directly on the subject matter or on management's assertion. For engagements conducted under this section, the service auditor is required to report directly on the subject matter.

Effective Date

.05 This section is effective for service auditors' reports for periods ending on or after June 15, 2011. Earlier implementation is permitted.

Objectives

.06 The objectives of the service auditor are to

a. obtain reasonable assurance about whether, in all material respects, based on suitable criteria,

   i. management's description of the service organization's system fairly presents the system that was designed and implemented throughout the specified period (or in the case of a type 1 report, as of a specified date).

   ii. the controls related to the control objectives stated in management's description of the service organization's system were suitably designed throughout the specified period (or in the case of a type 1 report, as of a specified date).

   iii. when included in the scope of the engagement, the controls operated effectively to provide reasonable assurance that the control objectives stated in management's description of the service organization's system were achieved throughout the specified period.

b. report on the matters in 6(a) in accordance with the service auditor's findings.

Definitions

.07 For purposes of this section, the following terms have the meanings attributed in the subsequent text:

Carve-out method. Method of addressing the services provided by a subservice organization whereby management's description of the service organization's system identifies the nature of the services performed by the subservice organization and excludes from the description and from the scope of the service auditor's engagement, the subservice organization's relevant control objectives and related controls. Management's description of the service organization's system and the scope of the service auditor's engagement include controls at the service organization that monitor the effectiveness of controls at the subservice organization, which may include management of the service organization's review of a service auditor's report on controls at the subservice organization.

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

Control objectives. The aim or purpose of specified controls at the service organization. Control objectives address the risks that controls are intended to mitigate.

Controls at a service organization. The policies and procedures at a service organization likely to be relevant to user entities' internal control over financial reporting. These policies and procedures are designed, implemented, and documented by the service organization to provide reasonable assurance about the achievement of the control objectives relevant to the services covered by the service auditor's report. (Ref: par. .A5)

Controls at a subservice organization. The policies and procedures at a subservice organization likely to be relevant to internal control over financial reporting of user entities of the service organization. These policies and procedures are designed, implemented, and documented by a subservice organization to provide reasonable assurance about the achievement of control objectives that are relevant to the services covered by the service auditor's report.

Criteria. The standards or benchmarks used to measure and present the subject matter and against which the service auditor evaluates the subject matter. (Ref: par. .A6)

Inclusive method. Method of addressing the services provided by a subservice organization whereby management's description of the service organization's system includes a description of the nature of the services provided by the subservice organization as well as the subservice organization's relevant control objectives and related controls. (Ref: par. .A7–.A9)

Internal audit function. The service organization's internal auditors and others, for example, members of a compliance or risk department, who perform activities similar to those performed by internal auditors. (Ref: par. .A10)

Report on management's description of a service organization's system and the suitability of the design of controls (referred to in this section as a *type 1 report*). A report that comprises the following:

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

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

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

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

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

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

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

c. A service auditor's report that

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

ii. includes a description of the tests of controls and the results thereof.

Service auditor. A practitioner who reports on controls at a service organization.

Service organization. An organization or segment of an organization that provides services to user entities, which are likely to be relevant to those user entities' internal control over financial reporting.

Service organization's assertion. A written assertion about the matters referred to in part (b) of the definition of *Report on management's description of a service organization's system and the suitability of the design and operating effectiveness of controls*, for a type 2 report; and, for a type 1 report, the matters referred to in part (b) of the definition of *Report on management's description of a service organization's system and the suitability of the design of controls*.

Service organization's system. The policies and procedures designed, implemented, and documented, by management of the service organization to provide user entities with the services covered by the service auditor's report. Management's description of the service organization's system identifies the services covered, the period to which the description relates (or in the case of a type 1 report, the date to which the description relates), the control objectives specified by management or an outside party, the party specifying the control objectives (if not specified by management), and the related controls. (Ref: par. .A11)

Subservice organization. A service organization used by another service organization to perform some of the services provided to user entities that are likely to be relevant to those user entities' internal control over financial reporting.

Test of controls. A procedure designed to evaluate the operating effectiveness of controls in achieving the control objectives stated in management's description of the service organization's system.

User auditor. An auditor who audits and reports on the financial statements of a user entity.

User entity. An entity that uses a service organization.

Requirements

Management and Those Charged With Governance

.08 When this section requires the service auditor to inquire of, request representations from, communicate with, or otherwise interact with management of the service organization, the service auditor should determine the appropriate person(s) within the service organization's management or governance structure with whom to interact. This should include consideration of which person(s) have the appropriate responsibilities for and knowledge of the matters concerned. (Ref: par. .A12)

Acceptance and Continuance

.09 A service auditor should accept or continue an engagement to report on controls at a service organization only if (Ref: par. .A13)

a. the service auditor has the capabilities and competence to perform the engagement. (Ref: par. .A14–.A15)

b. the service auditor's preliminary knowledge of the engagement circumstances indicates that

   i. the criteria to be used will be suitable and available to the intended user entities and their auditors;

   ii. the service auditor will have access to sufficient appropriate evidence to the extent necessary; and

   iii. the scope of the engagement and management's description of the service organization's system will not be so limited that they are unlikely to be useful to user entities and their auditors.

c. management agrees to the terms of the engagement by acknowledging and accepting its responsibility for the following:

   i. Preparing its description of the service organization's system and its assertion, including the completeness, accuracy, and method of presentation of the description and assertion. (Ref: par. .A16)

   ii. Having a reasonable basis for its assertion. (Ref: par. .A17)

   iii. Selecting the criteria to be used and stating them in the assertion.

   iv. Specifying the control objectives, stating them in the description of the service organization's system, and, if the control objectives are specified by law, regulation, or another party (for example, a user group or a professional body), identifying in the description the party specifying the control objectives.

v. Identifying the risks that threaten the achievement of the control objectives stated in the description and designing, implementing, and documenting controls that are suitably designed and operating effectively to provide reasonable assurance that the control objectives stated in the description of the service organization's system will be achieved. (Ref: par. .A18)

vi. Providing the service auditor with

(1) access to all information, such as records and documentation, including service level agreements, of which management is aware that is relevant to the description of the service organization's system and the assertion;

(2) additional information that the service auditor may request from management for the purpose of the examination engagement;

(3) unrestricted access to personnel within the service organization from whom the service auditor determines it is necessary to obtain evidence relevant to the service auditor's engagement; and

(4) written representations at the conclusion of the engagement.

vii. Providing a written assertion that will be included in, or attached to management's description of the service organization's system, and provided to user entities.

.10 If management will not provide the service auditor with a written assertion, the service auditor should not circumvent the requirement to obtain an assertion by performing a service auditor's engagement under section 101. (Ref: par. .A19)

.11 Management's subsequent refusal to provide a written assertion represents a scope limitation and consequently, the service auditor should withdraw from the engagement. If law or regulation does not allow the service auditor to withdraw from the engagement, the service auditor should disclaim an opinion.

Request to Change the Scope of the Engagement

.12 If management requests a change in the scope of the engagement before the completion of the engagement, the service auditor should be satisfied, before agreeing to the change, that a reasonable justification for the change exists. (Ref: par. .A20–.A21)

Assessing the Suitability of the Criteria (Ref: par. .A6 and .A22–.A23)

.13 As required by paragraph .23 of section 101, the service auditor should assess whether management has used suitable criteria

a. in preparing its description of the service organization's system;

b. in evaluating whether controls were suitably designed to achieve the control objectives stated in the description; and

c. in the case of a type 2 report, in evaluating whether controls operated effectively throughout the specified period to achieve the control objectives stated in the description of the service organization's system.

.14 In assessing the suitability of the criteria to evaluate whether management's description of the service organization's system is fairly presented, the service auditor should determine if the criteria include, at a minimum,

a. whether management's description of the service organization's system presents how the service organization's system was designed and implemented, including the following information about the service organization's system, if applicable:

i. The types of services provided including, as appropriate, the classes of transactions processed.

ii. The procedures, within both automated and manual systems, by which services are provided, including, as appropriate, procedures by which transactions are initiated, authorized, recorded, processed, corrected as necessary, and transferred to the reports and other information prepared for user entities.

iii. The related accounting records, whether electronic or manual, and supporting information involved in initiating, authorizing, recording, processing, and reporting transactions; this includes the correction of incorrect information and how information is transferred to the reports and other information prepared for user entities.

iv. How the service organization's system captures and addresses significant events and conditions other than transactions.

v. The process used to prepare reports and other information for user entities.

vi. The specified control objectives and controls designed to achieve those objectives, including as applicable, complementary user entity controls contemplated in the design of the service organization's controls.

vii. Other aspects of the service organization's control environment, risk assessment process, information and communication systems (including the related business processes), control activities, and monitoring controls that are relevant to the services provided. (Ref: par. A17 and .A24)

b. in the case of a type 2 report, whether management's description of the service organization's system includes relevant details of changes to the service organization's system during the period covered by the description. (Ref: par. .A44)

c. whether management's description of the service organization's system does not omit or distort information relevant to the service organization's system, while acknowledging that management's description of the service organization's system is prepared to meet the common needs of a broad range of user entities and their user auditors, and may not, therefore, include every aspect of the service organization's system that each individual user entity and its user auditor may consider important in its own particular environment.

.15 In assessing the suitability of the criteria to evaluate whether the controls are suitably designed, the service auditor should determine if the criteria include, at a minimum, whether *a.* the risks that threaten the achievement of the control objectives stated in management's description of the service organization's system have been identified by management.

b. the controls identified in management's description of the service organization's system would, if operating as described, provide reasonable assurance that those risks would not prevent the control objectives stated in the description from being achieved.

.16 In assessing the suitability of the criteria to evaluate whether controls operated effectively to provide reasonable assurance that the control objectives stated in management's description of the service organization's system were achieved, the service auditor should determine if the criteria include, at a minimum, whether the controls were consistently applied as designed throughout the specified period, including whether manual controls were applied by individuals who have the appropriate competence and authority.

Materiality

.17 When planning and performing the engagement, the service auditor should evaluate materiality with respect to the fair presentation of management's description of the service organization's system, the suitability of the design of controls to achieve the related control objectives stated in the description and, in the case of a type 2 report, the operating effectiveness of the controls to achieve the related control objectives stated in the description. (Ref: par. .A25–.A27)

Obtaining an Understanding of the Service Organization's System (Ref: par. .A28–.A30)

.18 The service auditor should obtain an understanding of the service organization's system, including controls that are included in the scope of the engagement.

Obtaining Evidence Regarding Management's Description of the Service Organization's System (Ref: par. .A26 and .A31–.A35)

.19 The service auditor should obtain and read management's description of the service organization's system and should evaluate whether those aspects of the description that are included in the scope of the engagement are presented fairly, including whether

a. the control objectives stated in management's description of the service organization's system are reasonable in the circumstances. (Ref: par. .A34)

b. controls identified in management's description of the service organization's system were implemented. (Ref: par. .A35)

c. complementary user entity controls, if any, are adequately described. (Ref: par. .A32)

d. services performed by a subservice organization, if any, are adequately described, including whether the inclusive method or the carve-out method has been used in relation to them.

.20 The service auditor should determine through inquiries made in combination with other procedures whether the service organization's system has been implemented. Such other procedures should include observation and inspection of records and other documentation of the manner in which the service organization's system operates and controls are applied. (Ref: par. .A35)

Obtaining Evidence Regarding the Design of Controls (Ref: par .A26 and .A36–.A39)

.21 The service auditor should determine which of the controls at the service organization are necessary to achieve the control objectives stated in management's description of the service organization's system and should assess whether those controls were suitably designed to achieve the control objectives by

- *a.* identifying the risks that threaten the achievement of the control objectives stated in management's description of the service organization's system, and (Ref: par. .A36)
- *b.* evaluating the linkage of the controls identified in management's description of the service organization's system with those risks.

Obtaining Evidence Regarding the Operating Effectiveness of Controls (Ref: par. .A26 and .A40–.A45)

Assessing Operating Effectiveness

.22 When performing a type 2 engagement, the service auditor should test those controls that the service auditor has determined are necessary to achieve the control objectives stated in management's description of the service organization's system and should assess their operating effectiveness throughout the period. Evidence obtained in prior engagements about the satisfactory operation of controls in prior periods does not provide a basis for a reduction in testing, even if it is supplemented with evidence obtained during the current period. (Ref: par. .A40–.A44)

.23 When performing a type 2 engagement, the service auditor should inquire about changes in the service organization's controls that were implemented during the period covered by the service auditor's report. If the service auditor believes the changes would be considered significant by user entities and their auditors, the service auditor should determine whether those changes are included in management's description of the service organization's system. If such changes are not included in the description, the service auditor should describe the changes in the service auditor's report and determine the effect on the service auditor's report. If the superseded controls are relevant to the achievement of the control objectives stated in the description, the service auditor should, if possible, test the superseded controls before the change. If the service auditor cannot test superseded controls relevant to the achievement of the control objectives stated in the description, the service auditor should determine the effect on the service auditor's report. (Ref: par. .A42(c) and .A45)

.24 When designing and performing tests of controls, the service auditor should

- *a.* perform other procedures in combination with inquiry to obtain evidence about the following:
  - i. How the control was applied.
  - ii. The consistency with which the control was applied.
  - iii. By whom or by what means the control was applied.

b. determine whether the controls to be tested depend on other controls, and if so, whether it is necessary to obtain evidence supporting the operating effectiveness of those other controls.

c. determine an effective method for selecting the items to be tested to meet the objectives of the procedure.

.25 When determining the extent of tests of controls and whether sampling is appropriate, the service auditor should consider the characteristics of the population of the controls to be tested, including the nature of the controls, the frequency of their application (for example, monthly, daily, many times per day), and the expected rate of deviation. AU-C section 530, *Audit Sampling*, addresses the auditor's use of statistical and nonstatistical sampling when designing and selecting the audit sample, performing tests of controls and tests of details, and evaluating the results from the sample. If the service auditor determines that sampling is appropriate, the service auditor should apply AU-C section 530. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Nature and Cause of Deviations

.26 The service auditor should investigate the nature and cause of any deviations identified, and should determine whether

a. identified deviations are within the expected rate of deviation and are acceptable. If so, the testing that has been performed provides an appropriate basis for concluding that the control operated effectively throughout the specified period.

b. additional testing of the control or of other controls is necessary to reach a conclusion about whether the controls related to the control objectives stated in management's description of the service organization's system operated effectively throughout the specified period.

c. the testing that has been performed provides an appropriate basis for concluding that the control did not operate effectively throughout the specified period.

.27 If, as a result of performing the procedures in paragraph .26, the service auditor becomes aware that any identified deviations have resulted from intentional acts by service organization personnel, the service auditor should assess the risk that management's description of the service organization's system is not fairly presented, the controls are not suitably designed, and in a type 2 engagement, the controls are not operating effectively. (Ref: par. .A31)

Using the Work of the Internal Audit Function

Obtaining an Understanding of the Internal Audit Function (Ref: par. .A46–.A47)

.28 If the service organization has an internal audit function, the service auditor should obtain an understanding of the nature of the responsibilities of the internal audit function and of the activities performed in order to determine whether the internal audit function is likely to be relevant to the engagement.

Planning to Use the Work of the Internal Audit Function

.29 When the service auditor intends to use the work of the internal audit function, the service auditor should determine whether the work of the internal audit function is likely to be adequate for the purposes of the engagement by evaluating the following:

a. The objectivity and technical competence of the members of the internal audit function

b. Whether the work of the internal audit function is likely to be carried out with due professional care

c. Whether it is likely that effective communication will occur between the internal audit function and the service auditor, including consideration of the effect of any constraints or restrictions placed on the internal audit function by the service organization

.30 If the service auditor determines that the work of the internal audit function is likely to be adequate for the purposes of the engagement, in determining the planned effect of the work of the internal audit function on the nature, timing, or extent of the service auditor's procedures, the service auditor should evaluate the following:

a. The nature and scope of specific work performed, or to be performed, by the internal audit function

b. The significance of that work to the service auditor's conclusions

c. The degree of subjectivity involved in the evaluation of the evidence gathered in support of those conclusions

Using the Work of the Internal Audit Function (Ref: par. .A48)

.31 In order for the service auditor to use specific work of the internal audit function, the service auditor should evaluate and perform procedures on that work to determine its adequacy for the service auditor's purposes.

.32 To determine the adequacy of specific work performed by the internal audit function for the service auditor's purposes, the service auditor should evaluate whether

a. the work was performed by members of the internal audit function having adequate technical training and proficiency;

b. the work was properly supervised, reviewed, and documented;

c. sufficient appropriate evidence was obtained to enable the internal audit function to draw reasonable conclusions;

d. conclusions reached are appropriate in the circumstances and any reports prepared by the internal audit function are consistent with the results of the work performed; and

e. exceptions relevant to the engagement or unusual matters disclosed by the internal audit function are properly resolved.

Effect on the Service Auditor's Report

.33 If the work of the internal audit function has been used, the service auditor should not make reference to that work in the service auditor's opinion. Notwithstanding its degree of autonomy and objectivity, the internal audit function is not independent of the service organization. The service auditor has sole responsibility for the opinion expressed in the service auditor's report and, accordingly, that responsibility is not reduced by the service auditor's use of the work of the internal audit function. (Ref: par. .A49)

.34 In the case of a type 2 report, if the work of the internal audit function has been used in performing tests of controls, that part of the service auditor's report that describes the service auditor's tests of controls and results thereof should include a description of the internal auditor's work and of the service auditor's procedures with respect to that work. (Ref: par. .A50)

Direct Assistance

.35 When the service auditor uses members of the service organization's internal audit function to provide direct assistance, the service auditor should adapt and apply the requirements in paragraph .27 of AU-C section 610, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Written Representations (Ref: par. .A51–.A55)

.36 The service auditor should request management to provide written representations that

a. reaffirm its assertion included in or attached to the description of the service organization's system;

b. it has provided the service auditor with all relevant information and access agreed to; and [1]

c. it has disclosed to the service auditor any of the following of which it is aware:

  i. Instances of noncompliance with laws and regulations or uncorrected errors attributable to the service organization that may affect one or more user entities.

  ii. Knowledge of any actual, suspected, or alleged intentional acts by management or the service organization's employees, that could adversely affect the fairness of the presentation of management's description of the service organization's system or the completeness or achievement of the control objectives stated in the description.

  iii. Design deficiencies in controls.

  iv. Instances when controls have not operated as described.

  v. Any events subsequent to the period covered by management's description of the service organization's system up to the date of the service auditor's report that could have a significant effect on management's assertion.

.37 If a service organization uses a subservice organization and management's description of the service organization's system uses the inclusive method, the service auditor also should obtain the written representations identified in paragraph .36 from management of the subservice organization.

.38 The written representations should be in the form of a representation letter addressed to the service auditor and should be as of the same date as the date of the service auditor's report.

.39 If management does not provide one or more of the written representations requested by the service auditor, the service auditor should do the following:

a. Discuss the matter with management

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[1] See paragraph .09(c)(vi)(1).

b. Evaluate the effect of such refusal on the service auditor's assessment of the integrity of management and evaluate the effect that this may have on the reliability of management's representations and evidence in general

c. Take appropriate actions, which may include disclaiming an opinion or withdrawing from the engagement

If management refuses to provide the representations in paragraphs .36(a)–.36(b) of this section, the service auditor should disclaim an opinion or withdraw from the engagement.

Other Information (Ref: par. .A56–.A57)

.40 The service auditor should read other information, if any, included in a document containing management's description of the service organization's system and the service auditor's report to identify material inconsistencies, if any, with that description. While reading the other information for the purpose of identifying material inconsistencies, the service auditor may become aware of an apparent misstatement of fact in the other information.

.41 If the service auditor becomes aware of a material inconsistency or an apparent misstatement of fact in the other information, the service auditor should discuss the matter with management. If the service auditor concludes that there is a material inconsistency or a misstatement of fact in the other information that management refuses to correct, the service auditor should take further appropriate action.[2]

Subsequent Events

.42 The service auditor should inquire whether management is aware of any events subsequent to the period covered by management's description of the service organization's system up to the date of the service auditor's report that could have a significant effect on management's assertion. If the service auditor becomes aware, through inquiry or otherwise, of such an event, or any other event that is of such a nature and significance that its disclosure is necessary to prevent users of a type 1 or type 2 report from being misled, and information about that event is not disclosed by management in its description, the service auditor should disclose such event in the service auditor's report.

.43 The service auditor has no responsibility to keep informed of events subsequent to the date of the service auditor's report; however, after the release of the service auditor's report, the service auditor may become aware of conditions that existed at the report date that might have affected management's assertion and the service auditor's report had the service auditor been aware of them. The evaluation of such subsequent information is similar to the evaluation of facts discovered subsequent to the date of the report on an audit of financial statements, as described in AU-C section 560, *Subsequent Events and Subsequently Discovered Facts*, and therefore, the service auditor should adapt and apply AU-C section 560. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Documentation (Ref: par. .A58)

.44 The service auditor should prepare documentation that is sufficient to enable an experienced service auditor, having no previous connection with the engagement, to understand the following:

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[2] See paragraphs .91–.94 of section 101, *Attest Engagements*.

a. The nature, timing, and extent of the procedures performed to comply with this section and with applicable legal and regulatory requirements

b. The results of the procedures performed and the evidence obtained

c. Significant findings or issues arising during the engagement, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions

.45 In documenting the nature, timing, and extent of procedures performed, the service auditor should record the following:

a. Identifying characteristics of the specific items or matters being tested

b. Who performed the work and the date such work was completed

c. Who reviewed the work performed and the date and extent of such review

.46 If the service auditor uses specific work of the internal audit function, the service auditor should document the conclusions reached regarding the evaluation of the adequacy of the work of the internal audit function and the procedures performed by the service auditor on that work.

.47 The service auditor should document discussions of significant findings or issues with management and others, including the nature of the significant findings or issues, when the discussions took place, and with whom.

.48 If the service auditor has identified information that is inconsistent with the service auditor's final conclusion regarding a significant finding or issue, the service auditor should document how the service auditor addressed the inconsistency.

.49 The service auditor should assemble the engagement documentation in an engagement file and complete the administrative process of assembling the final engagement file on a timely basis, no later than 60 days following the service auditor's report release date.

.50 After the assembly of the final engagement file has been completed, the service auditor should not delete or discard documentation before the end of its retention period.

.51 If the service auditor finds it necessary to modify existing engagement documentation or add new documentation after the assembly of the final engagement file has been completed, the service auditor should, regardless of the nature of the modifications or additions, document the following:

a. The specific reasons for making them

b. When and by whom they were made and reviewed

Preparing the Service Auditor's Report

Content of the Service Auditor's Report (Ref: par. .A59)

.52 A service auditor's type 2 report should include the following elements:

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

b. An addressee.

c. Identification of

i. management's description of the service organization's system and the function performed by the system.

ii. any parts of management's description of the service organization's system that are not covered by the service auditor's report. (Ref: par. .A56)

iii. any information included in a document containing the service auditor's report that is not covered by the service auditor's report. (Ref: par. .A56)

iv. the criteria.

v. any services performed by a subservice organization and whether the carve-out method or the inclusive method was used in relation to them. Depending on which method is used, the following should be included:

(1) If the carve-out method was used, a statement that management's description of the service organization's system excludes the control objectives and related controls at relevant subservice organizations, and that the service auditor's procedures do not extend to the subservice organization.

(2) If the inclusive method was used, a statement that management's description of the service organization's system includes the subservice organization's specified control objectives and related controls, and that the service auditor's procedures included procedures related to the subservice organization.

d. If management's description of the service organization's system refers to the need for complementary user entity controls, a statement that the service auditor has not evaluated the suitability of the design or operating effectiveness of complementary user entity controls, and that the control objectives stated in the description can be achieved only if complementary user entity controls are suitably designed and operating effectively, along with the controls at the service organization.

e. A reference to management's assertion and a statement that management is responsible for (Ref: par. .A60)

i. preparing the description of the service organization's system and the assertion, including the completeness, accuracy, and method of presentation of the description and assertion;

ii. providing the services covered by the description of the service organization's system;

iii. specifying the control objectives unless the control objectives are specified by law, regulation, or another party, and stating them in the description of the service organization's system;

iv. identifying the risks that threaten the achievement of the control objectives;

v. selecting the criteria; and

vi. designing, implementing, and documenting controls that are suitably designed and operating effectively to achieve the related control objectives stated in the description of the service organization's system.

f. A statement that the service auditor's responsibility is to express an opinion on the fairness of the presentation of management's description of the service organization's system and on the suitability of the design and operating effectiveness of the controls to achieve the related control objectives stated in the description, based on the service auditor's examination.

g. A statement that the examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and that those standards require the service auditor to plan and perform the examination to obtain reasonable assurance about whether management's description of the service organization's system is fairly presented and the controls are suitably designed and operating effectively throughout the specified period to achieve the related control objectives.

h. A statement that an examination of management's description of a service organization's system and the suitability of the design and operating effectiveness of the service organization's controls to achieve the related control objectives stated in the description involves performing procedures to obtain evidence about the fairness of the presentation of the description and the suitability of the design and operating effectiveness of those controls to achieve the related control objectives stated in the description.

i. A statement that the examination included assessing the risks that management's description of the service organization's system is not fairly presented and that the controls were not suitably designed or operating effectively to achieve the related control objectives.

j. A statement that the examination also included testing the operating effectiveness of those controls that the service auditor considers necessary to provide reasonable assurance that the related control objectives stated in management's description of the service organization's system were achieved.

k. A statement that an examination engagement of this type also includes evaluating the overall presentation of management's description of the service organization's system and suitability of the control objectives stated in the description.

l. A statement that the service auditor believes the examination provides a reasonable basis for his or her opinion.

m. A statement about the inherent limitations of controls, including the risk of projecting to future periods any evaluation of the fairness of the presentation of management's description of the service organization's system or conclusions about the suitability of the design or operating effectiveness of controls.

n. The service auditor's opinion on whether, in all material respects, based on the criteria described in management's assertion,

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

ii. the controls related to the control objectives stated in management's description of the service organization's system were suitably designed to provide reasonable assurance that those control objectives would be achieved if the controls operated effectively throughout the specified period.

iii. the controls the service auditor tested, which were those necessary to provide reasonable assurance that the control objectives stated in management's description of the service organization's system were achieved, operated effectively throughout the specified period.

iv. if the application of complementary user entity controls is necessary to achieve the related control objectives stated in management's description of the service organization's system, a reference to this condition.

o. A reference to a description of the service auditor's tests of controls and the results thereof, that includes

i. identification of the controls that were tested, whether the items tested represent all or a selection of the items in the population, and the nature of the tests in sufficient detail to enable user auditors to determine the effect of such tests on their risk assessments. (Ref: par. .A50)

ii. if deviations have been identified in the operation of controls included in the description, the extent of testing performed by the service auditor that led to the identification of the deviations (including the number of items tested), and the number and nature of the deviations noted (even if, on the basis of tests performed, the service auditor concludes that the related control objective was achieved). (Ref: par. .A65)

p. A statement restricting the use of the service auditor's report to management of the service organization, user entities of the service organization's system during some or all of the period covered by the service auditor's report, and the independent auditors of such user entities. (Ref: par. .A61–.A64)

q. The date of the service auditor's report.

r. The name of the service auditor and the city and state where the service auditor maintains the office that has responsibility for the engagement.

.53 A service auditor's type 1 report should include the following elements:

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

b. An addressee.

c. Identification of

i. management's description of the service organization's system and the function performed by the system.

ii. any parts of management's description of the service organization's system that are not covered by the service auditor's report. (Ref: par. .A56)

iii. any information included in a document containing the service auditor report that is not covered by the service auditor's report. (Ref: par. .A56)

iv. the criteria.

v. any services performed by a subservice organization and whether the carve-out method or the inclusive method was used in relation to them. Depending on which method is used, the following should be included:

(1) If the carve-out method was used, a statement that management's description of the service organization's system excludes the control objectives and related controls at relevant subservice organizations, and that the service auditor's procedures do not extend to the subservice organization.

(2) If the inclusive method was used, a statement that management's description of the service organization's system includes the subservice organization's specified control objectives and related controls, and that the service auditor's procedures included procedures related to the subservice organization.

d. If management's description of the service organization's system refers to the need for complementary user entity controls, a statement that the service auditor has not evaluated the suitability of the design or operating effectiveness of complementary user entity controls, and that the control objectives stated in the description can be achieved only if complementary user entity controls are suitably designed and operating effectively, along with the controls at the service organization.

e. A reference to management's assertion and a statement that management is responsible for (Ref: par. .A60)

i. preparing the description of the service organization's system and assertion, including the completeness, accuracy, and method of presentation of the description and assertion;

ii. providing the services covered by the description of the service organization's system;

iii. specifying the control objectives, unless the control objectives are specified by law, regulation, or another party, and stating them in the description of the service organization's system;

iv. identifying the risks that threaten the achievement of the control objectives,

v. selecting the criteria; and

vi. designing, implementing, and documenting controls that are suitably designed and operating effectively to achieve the related control objectives stated in the description of the service organization's system.

f. A statement that the service auditor's responsibility is to express an opinion on the fairness of the presentation of management's description of the service organization's system and on the suitability of the design of the controls to achieve the related control objectives stated in the description, based on the service auditor's examination.

g. A statement that the examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants, and that those standards require the service auditor to plan and perform the examination to obtain reasonable assurance about whether management's description of the service organization's system is fairly presented and the controls are suitably designed as of the specified date to achieve the related control objectives.

h. A statement that the service auditor has not performed any procedures regarding the operating effectiveness of controls and, therefore, expresses no opinion thereon.

i A statement that an examination of management's description of a service organization's system and the suitability of the design of the service organization's controls to achieve the related control objectives stated in the description involves performing procedures to obtain evidence about the fairness of the presentation of the description and the suitability of the design of those controls to achieve the related control objectives stated in the description.

j. A statement that the examination included assessing the risks that management's description of the service organization's system is not fairly presented and that the controls were not suitably designed to achieve the related control objectives.

k. A statement that an examination engagement of this type also includes evaluating the overall presentation of management's description of the service organization's system and suitability of the control objectives stated in the description.

l. A statement that the service auditor believes the examination provides a reasonable basis for his or her opinion.

m. A statement about the inherent limitations of controls, including the risk of projecting to future periods any evaluation of the fairness of the presentation of management's description of the service organization's system or conclusions about the suitability of the design of the controls to achieve the related control objectives.

n. The service auditor's opinion on whether, in all material respects, based on the criteria described in management's assertion,

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

   ii. the controls related to the control objectives stated in management's description of the service organization's system were suitably designed to provide reasonable assurance that those control objectives would be achieved if the controls operated effectively as of the specified date.

   iii. if the application of complementary user entity controls is necessary to achieve the related control objectives stated in management's description of the service organization's system, a reference to this condition.

o. A statement restricting the use of the service auditor's report to management of the service organization, user entities of the service organization's system as of the end of the period covered by the service auditor's report, and the independent auditors of such user entities. (Ref: par. .A61–.A64)

p. The date of the service auditor's report.

q. The name of the service auditor and the city and state where the service auditor maintains the office that has responsibility for the engagement.

Report Date

.54 The service auditor should date the service auditor's report no earlier than the date on which the service auditor has obtained sufficient appropriate evidence to support the service auditor's opinion.

Modified Opinions (Ref: par. .A66)

.55 The service auditor's opinion should be modified and the service auditor's report should contain a clear description of all the reasons for the modification, if the service auditor concludes that

a. management's description of the service organization's system is not fairly presented, in all material respects;

b. the controls are not suitably designed to provide reasonable assurance that the control objectives stated in management's description of the service organization's system would be achieved if the controls operated as described;

c. in the case of a type 2 report, the controls did not operate effectively throughout the specified period to achieve the related control objectives stated in management's description of the service organization's system; or

d. the service auditor is unable to obtain sufficient appropriate evidence

.56 If the service auditor plans to disclaim an opinion because of the inability to obtain sufficient appropriate evidence, and, based on the limited procedures performed, has concluded that,

a. certain aspects of management's description of the service organization's system are not fairly presented, in all material respects;

b. certain controls were not suitably designed to provide reasonable assurance that the control objectives stated in management's description of the service organization's system would be achieved if the controls operated as described; or

c. in the case of a type 2 report, certain controls did not operate effectively throughout the specified period to achieve the related control objectives stated in management's description of the service organization's system,

the service auditor should identify these findings in his or her report.

.57 If the service auditor plans to disclaim an opinion, the service auditor should not identify the procedures that were performed nor include statements describing the characteristics of a service auditor's engagement in the service auditor's report; to do so might overshadow the disclaimer.

Other Communication Responsibilities

.58 If the service auditor becomes aware of incidents of noncompliance with laws and regulations, fraud, or uncorrected errors attributable to management or other service organization personnel that are not clearly trivial and that may affect one or more user entities, the service auditor should determine the effect of such incidents on management's description of the service organization's system, the achievement of the control objectives, and the service auditor's report.

Additionally, the service auditor should determine whether this information has been communicated appropriately to affected user entities. If the information has not been so communicated, and management of the service organization is unwilling to do so, the service auditor should take appropriate action. (Ref: par. .A67)

Application and Other Explanatory Material

Scope of This Section

.A1 *Internal control* is a process designed to provide reasonable assurance regarding the achievement of objectives related to the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Controls related to a service organization's operations and compliance objectives may be relevant to a user entity's internal control over financial reporting. Such controls may pertain to assertions about presentation and disclosure relating to account balances, classes of transactions or disclosures, or may pertain to evidence that the user auditor evaluates or uses in applying auditing procedures. For example, a payroll processing service organization's controls related to the timely remittance of payroll deductions to government authorities may be relevant to a user entity because late remittances could incur interest and penalties that would result in a liability for the user entity. Similarly, a service organization's controls over the acceptability of investment transactions from a regulatory perspective may be considered relevant to a user entity's presentation and disclosure of transactions and account balances in its financial statements. (Ref: par. .01)

.A2 Paragraph .02 of this section refers to other engagements that the practitioner may perform and report on under section 101 to report on controls at a service organization. Paragraph .02 is not, however, intended to

- provide for the alteration of the definitions of *service organization* and *service organization's system* in paragraph .07 to permit reports issued under this section to include in the description of the service organization's system aspects of their services (including relevant control objectives and related controls) not likely to be relevant to user entities' internal control over financial reporting, or
- permit a report to be issued that combines reporting under this section on a service organization's controls that are likely to be relevant to user entities' internal control over financial reporting, with reporting under section 101 on controls that are not likely to be relevant to user entities' internal control over financial reporting. (Ref: par. .02(a))

.A3 When a service auditor conducts an engagement under section 101 to report on controls at a service organization other than those controls likely to be relevant to user entities' internal control over financial reporting, and the service auditor intends to use the guidance in this section in planning and performing that engagement, the service auditor may encounter issues that differ significantly from those associated with engagements to report on a service organization's controls likely to be relevant to user entities' internal control over financial reporting. For example,

- identification of suitable and available criteria, as prescribed in paragraphs .23–.34 of section 101, for evaluating the fairness of presentation of management's description of the service organization's system and the suitability of the design and the operating effectiveness of the controls.
- identification of appropriate control objectives, and the basis for evaluating the reasonableness of the control objectives in the circumstances of the particular engagement.

- identification of the intended users of the report and the manner in which they intend to use the report.
- relevance and appropriateness of the definitions in paragraph .07 of this section, many of which specifically relate to internal control over financial reporting.
- application of references to auditing standards (AU-C sections) that are intended to provide the service auditor with guidance relevant to internal control over financial reporting.
- application of the concept of materiality in the circumstances of the particular engagement.
- developing the language to be used in the practitioner's report, including addressing paragraphs .84–.87 of section 101, which identify the elements to be included in an examination report. (Ref: par. .02(a))

.A4 When management of the service organization is not responsible for the design of the system, it is unlikely that management of the service organization will be in a position to assert that the system is suitably designed. Controls cannot operate effectively unless they are suitably designed. Because of the inextricable link between the suitability of the design of controls and their operating effectiveness, the absence of an assertion with respect to the suitability of design will likely preclude the service auditor from opining on the operating effectiveness of controls. As an alternative, the practitioner may perform tests of controls in either an agreed-upon procedures engagement under section 201, *Agreed Upon Procedures Engagements*, or an examination of the operating effectiveness of the controls under section 101. (Ref: par. .02(b))

Definitions

Controls at a Service Organization (Ref: par. .07)

.A5 The policies and procedures referred to in the definition of *controls at a service organization* in paragraph .07 include aspects of user entities' information systems maintained by the service organization and may also include aspects of one or more of the other components of internal control at a service organization. For example, the definition of *controls at a service organization* may include aspects of the service organization's control environment, monitoring, and control activities when they relate to the services provided. Such definition does not, however, include controls at a service organization that are not related to the achievement of the control objectives stated in management's description of the service organization's system; for example, controls related to the preparation of the service organization's own financial statements.

Criteria (Ref: par. .07 and .14–.16)

.A6 For the purposes of engagements performed in accordance with this section, criteria need to be available to user entities and their auditors to enable them to understand the basis for the service organization's assertion about the fair presentation of management's description of the service organization's system, the suitability of the design of controls that address control objectives stated in the description of the system and, in the case of a type 2 report, the operating effectiveness of such controls. Information about suitable criteria is provided in paragraphs .23–.34 of section 101. Paragraphs .14–.16 of this section discuss the criteria for evaluating the fairness of the presentation of management's description of the service organization's system and the suitability of the design and operating effectiveness of the controls.

Inclusive Method (Ref: par. .07)

.A7 As indicated in the definition of *inclusive method* in paragraph .07, a service organization that uses a subservice organization presents management's description of the service organization's system to include a description of the services provided by the subservice organization as well as the subservice organization's relevant control objectives and related controls. When the inclusive method is used, the requirements of this section also apply to the services provided by the subservice organization, including the requirement to obtain management's acknowledgement and acceptance of responsibility for the matters in paragraph .09(c)(i)–(vii) as they relate to the subservice organization.

.A8 Performing procedures at the subservice organization entails coordination and communication between the service organization, the subservice organization, and the service auditor. The inclusive method generally is feasible if, for example, the service organization and the subservice organization are related, or if the contract between the service organization and the subservice organization provides for issuance of a service auditor's report. If the service auditor is unable to obtain an assertion from the subservice organization regarding management's description of the service organization's system provided, including the relevant control objectives and related controls at the subservice organization, the service auditor is unable to use the inclusive method but may instead use the carve-out method.

.A9 There may be instances when the service organization's controls, such as monitoring controls, permit the service organization to include in its assertion the relevant aspects of the subservice organization's system, including the relevant control objectives and related controls of the subservice organization. In such instances, the service auditor is basing his or her opinion solely on the controls at the service organization, and hence, the inclusive method is not applicable.

Internal Audit Function (Ref: par. .07)

.A10 The "others" referenced in the definition of *internal audit function* may be individuals who perform activities similar to those performed by internal auditors and include service organization personnel (in addition to internal auditors), and third parties working under the direction of management or those charged with governance.

Service Organization's System (Ref: par. .07)

.A11 The policies and procedures referred to in the definition of *service organization's system* refer to the guidelines and activities for providing transaction processing and other services to user entities and include the infrastructure, software, people, and data that support the policies and procedures.

Management and Those Charged With Governance (Ref: par. .08)

.A12 Management and governance structures vary by entity, reflecting influences such as size and ownership characteristics. Such diversity means that it is not possible for this section to specify for all engagements the person(s) with whom the service auditor is to interact regarding particular matters. For example, the service organization may be a segment of an organization and not a separate legal entity. In such cases, identifying the appropriate management personnel or those charged with governance from whom to request written representations may require the exercise of professional judgment.

Acceptance and Continuance

.A13 If one or more of the conditions in paragraph .09 are not met and the service auditor is nevertheless required by law or regulation to accept or continue an engagement to report on controls at a service organization, the service auditor is required, in accordance with the requirements in paragraphs .55–.56, to determine the effect on the service auditor's report of one or more of such conditions not being met. (Ref: par. .09)

Capabilities and Competence to Perform the Engagement (Ref: par. .09a)

.A14 Relevant capabilities and competence to perform the engagement include matters such as the following:

- Knowledge of the relevant industry
- An understanding of information technology and systems
- Experience in evaluating risks as they relate to the suitable design of controls
- Experience in the design and execution of tests of controls and the evaluation of the results

.A15 In performing a service auditor's engagement, the service auditor need not be independent of each user entity. (Ref: par. .09a)

Management's Responsibility for Documenting the Service Organization's System (Ref: par. .09(c)(i))

.A16 Management of the service organization is responsible for documenting the service organization's system. No one particular form of documentation is prescribed and the extent of documentation may vary depending on the size and complexity of the service organization and its monitoring activities.

Reasonable Basis for Management's Assertion (Ref: par. .07, definition of service organization's system; par. .09(c)(ii) and .14(a)(vii))

.A17 Management's monitoring activities may provide evidence of the design and operating effectiveness of controls in support of management's assertion. *Monitoring of controls* is a process to assess the effectiveness of internal control performance over time. It involves assessing the effectiveness of controls on a timely basis, identifying and reporting deficiencies to appropriate individuals within the service organization, and taking necessary corrective actions. Management accomplishes monitoring of controls through ongoing activities, separate evaluations, or a combination of the two. Ongoing monitoring activities are often built into the normal recurring activities of an entity and include regular management and supervisory activities. Internal auditors or personnel performing similar functions may contribute to the monitoring of a service organization's activities. Monitoring activities may also include using information communicated by external parties, such as customer complaints and regulator comments, which may indicate problems or highlight areas in need of improvement. The greater the degree and effectiveness of ongoing monitoring, the less need for separate evaluations. Usually, some combination of ongoing monitoring and separate evaluations will ensure that internal control maintains its effectiveness over time. The service auditor's report on controls is not a substitute for the service organization's own processes to provide a reasonable basis for its assertion.

Identification of Risks (Ref: par. .09(c)(v))

.A18 Control objectives relate to risks that controls seek to mitigate. For example, the risk that a transaction is recorded at the wrong amount or in the wrong period can be expressed as a control objective that transactions are recorded at the correct amount and in the correct period. Management is responsible for identifying the risks that threaten achievement of the control objectives stated in management's description of the service organization's system. Management may have a formal or informal process for identifying relevant risks. A formal process may include estimating the significance of identified risks, assessing the likelihood of their occurrence, and deciding about actions to address them. However, because control objectives relate to risks that controls seek to mitigate, thoughtful identification by management of control objectives when designing, implementing, and documenting the service organization's system may itself comprise an informal process for identifying relevant risks.

Management's Refusal to Provide a Written Assertion

.A19 A recent change in service organization management or the appointment of the service auditor by a party other than management are examples of situations that may cause management to be unwilling to provide the service auditor with a written assertion. However, other members of management may be in a position to, and will agree to, sign the assertion so that the service auditor can meet the requirement of paragraph .09(c)(vii). (Ref: par. .10)

Request to Change the Scope of the Engagement (Ref: par. .12)

.A20 A request to change the scope of the engagement may not have a reasonable justification if, for example, the request is made

- to exclude certain control objectives at the service organization from the scope of the engagement because of the likelihood that the service auditor's opinion would be modified with respect to those control objectives.
- to prevent the disclosure of deviations identified at a subservice organization by requesting a change from the inclusive method to the carve-out method.

.A21 A request to change the scope of the engagement may have a reasonable justification when, for example, the request is made to exclude from the engagement a subservice organization because the service organization cannot arrange for access by the service auditor, and the method used for addressing the services provided by that subservice organization is changed from the inclusive method to the carve-out method.

Assessing the Suitability of the Criteria (Ref: par. .13–.16)

.A22 Section 101 requires a practitioner, among other things, to determine whether the subject matter is capable of evaluation against criteria that are suitable and available to users. As indicated in paragraph .27 of section 101, regardless of who establishes or develops the criteria, management is responsible for selecting the criteria and for determining whether the criteria are appropriate. The subject matter is the underlying condition of interest to intended users of an attestation report. The following table identifies the subject matter and minimum criteria for each of the opinions in type 2 and type 1 reports.

	Subject Matter	*Criteria*	*Comment*
Opinion on the fair presentation of management's description of the service organization's system (type 1 and type 2 reports).	Management's description of the service organization's system that is likely to be relevant to user entities' internal control over financial reporting and is covered by the service auditor's report, and management's assertion about whether the description is fairly presented.	Management's description of the service organization's system is fairly presented if it *a.* presents how the service organization's system was designed and implemented including, as appropriate, the matters identified in paragraph .14(a) and, in the case of a type 2 report, includes relevant details of changes to the service organization's system during the period covered by the description. *b.* does not omit or distort information relevant to the service organization's system, while acknowledging that management's description of the service organization's system is prepared to meet the common needs of a broad range of user entities and may not, therefore, include every aspect of the service organization's system that each individual user entity may consider important in its own particular environment.	The specific wording of the criteria for this opinion may need to be tailored to be consistent with criteria established by, for example, law, regulation, user groups, or a professional body. Criteria for evaluating management's description of the service organization's system are provided in paragraph .14. Paragraphs .19–.20 and .A31–.A33 offer further guidance on determining whether these criteria are met.

(continued)

	Subject Matter	*Criteria*	*Comment*	
Opinion on suitability of design and operating effectiveness (type 2 reports).	The design and operating effectiveness of the controls that are necessary to achieve the control objectives stated in management's description of the service organization's system.	The controls are suitably designed and operating effectively to achieve the control objectives stated in management's description of the service organization's system if *a.* management has identified the risks that threaten the achievement of the control objectives stated in management's description of the service organization's system. *b.* the controls identified in management's description of the service organization's system would, if operating as described, provide reasonable assurance that those risks would not prevent the control objectives stated in the description from being achieved. *c.* the controls were consistently applied as designed throughout the specified period. This includes whether manual controls were applied by individuals who have the appropriate competence and authority.	When the criteria for this opinion are met, controls will have provided reasonable assurance that the related control objectives stated in management's description of the service organization's system were achieved throughout the specified period.	The control objectives stated in management's description of the service organization's system are part of the criteria for these opinions. The control objectives stated in the description will differ from engagement to engagement. If the service auditor concludes that the control objectives stated in the description are not fairly presented, then those control objectives would not be suitable as part of the criteria for forming an opinion on the design and operating effectiveness of the controls.

	Subject Matter	*Criteria*	*Comment*
Opinion on suitability of design (type 1 reports).	The suitability of the design of the controls necessary to achieve the control objectives stated in management's description of the service organization's system and relevant to the services covered by the service auditor's report.	The controls are suitably designed to achieve the control objectives stated in management's description of the service organization's system if *a.* management has identified the risks that threaten the achievement of the control objectives stated in its description of the service organization's system. *b.* the controls identified in management's description of the service organization's system would, if operating as described, provide reasonable assurance that those risks would not prevent the control objectives stated in the description from being achieved.	Meeting these criteria does not, of itself, provide any assurance that the control objectives stated in management's description of the service organization's system were achieved because no evidence has been obtained about the operating effectiveness of the controls.

.A23 Paragraph .14(a) identifies a number of elements that are included in management's description of the service organization's system as appropriate. These elements may not be appropriate if the system being described is not a system that processes transactions; for example, if the system relates to general controls over the hosting of an IT application but not the controls embedded in the application itself. (Ref: par. .14)

.A24 The requirement to include in management's description of the service organization's system "other aspects of the service organization's control environment, risk assessment process, information and communication systems (including the related business processes), control activities, and monitoring controls, that are relevant to the services provided" is also applicable to the internal control components of subservice organizations used by the service organization when the inclusive method is used. See AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, for a discussion of these components. (Ref: par. .14(a)(vii)) [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

Materiality (Ref: par. .17)

.A25 In an engagement to report on controls at a service organization, the concept of materiality relates to the information being reported on, not the financial statements of user entities. The service auditor plans and performs procedures to determine whether management's description of the service organization's system is fairly presented, in all material respects; whether controls at the service organization are suitably designed in all material respects to achieve the control objectives stated in the description; and in the case of a type 2 report, whether controls at the service organization operated effectively throughout the specified period in all material respects to achieve the control objectives stated in the description. The concept of materiality takes into account that the service auditor's report provides information about the service organization's system to meet the common information needs of a broad range of user entities and their auditors who have an understanding of the manner in which the system is being used by a particular user entity for financial reporting.

.A26 Materiality with respect to the fair presentation of management's description of the service organization's system and with respect to the design of controls primarily includes the consideration of qualitative factors; for example, whether

- management's description of the service organization's system includes the significant aspects of the processing of significant transactions.
- management's description of the service organization's system omits or distorts relevant information.
- the controls have the ability, as designed, to provide reasonable assurance that the control objectives stated in management's description of the service organization's system would be achieved.

Materiality with respect to the operating effectiveness of controls includes the consideration of both quantitative and qualitative factors; for example, the tolerable rate and observed rate of deviation (a quantitative matter) and the nature and cause of any observed deviations (a qualitative matter).

.A27 The concept of materiality is not applied when disclosing, in the description of the tests of controls, the results of those tests when deviations have been identified. This is because, in the particular circumstances of a specific user entity or user auditor, a deviation may have significance beyond whether or not, in the opinion of the service auditor, it prevents a control from operating effectively. For example, the control to which the deviation relates may be particularly significant in preventing a certain type of error that may be material in the particular circumstances of a user entity's financial statements.

Obtaining an Understanding of the Service Organization's System (Ref: par. .18)

.A28 Obtaining an understanding of the service organization's system, including related controls, assists the service auditor in the following:

- Identifying the boundaries of the system and how it interfaces with other systems
- Assessing whether management's description of the service organization's system fairly presents the service organization's system that has been designed and implemented
- Determining which controls are necessary to achieve the control objectives stated in management's description of the service organization's system, whether controls were suitably designed to achieve those control objectives, and, in the case of a type 2 report, whether controls were operating effectively throughout the period to achieve those control objectives

.A29 Management's description of the service organization's system includes "aspects of the service organization's control environment, risk assessment process, information and communication systems (including relevant business processes), control activities and monitoring activities that are relevant to the services provided." Although aspects of the service organization's control environment, risk assessment process, and monitoring activities may not be presented in the description in the context of control objectives, they may nevertheless be necessary to achieve the specified control objectives stated in the description. Likewise, deficiencies in these controls may have an effect on the service auditor's assessment of whether the controls, taken as a whole, were suitably designed or operating effectively to achieve the specified control objectives. See AU-C section 315 for a discussion of these components of internal control. [Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.A30 The service auditor's procedures to obtain the understanding referred to in paragraph .A28 may include the following:

- Inquiring of management and others within the service organization who, in the service auditor's judgment, may have relevant information
- Observing operations and inspecting documents, reports, and printed and electronic records of transaction processing
- Inspecting a selection of agreements between the service organization and user entities to identify their common terms
- Reperforming the application of a control

One or more of the preceding procedures may be accomplished through the performance of a walkthrough.

Obtaining Evidence Regarding Management's Description of the Service Organization's System (Ref: par. .19–.20)

.A31 In a service auditor's examination engagement, the service auditor plans and performs the engagement to obtain reasonable assurance of detecting errors or omissions in management's description of the service organization's system and instances in which control objectives were not achieved. Absolute assurance is not attainable because of factors such as the need for judgment, the use of sampling, and the inherent limitations of controls at the service organization that affect whether the description is fairly presented and the controls are suitably designed and operating effectively to achieve the control objectives, and because much of the evidence available to the service auditor is persuasive rather than conclusive in nature. Also, procedures that are effective for detecting unintentional errors or omissions in the description, and instances in which control objectives were not achieved, may be ineffective for detecting intentional errors or omissions in the description and instances in which the control objectives were not achieved that are concealed through collusion between service organization personnel and a third party or among management or employees of the service organization. Therefore, the subsequent discovery of the existence of material omissions or errors in the description or instances in which control objectives were not achieved does not, in and of itself, evidence inadequate planning, performance, or judgment on the part of the service auditor. (Ref: par. .27)

.A32 Considering the following questions may assist the service auditor in determining whether management's description of the service organization's system is fairly presented, in all material respects:

- Does management's description address the major aspects of the service provided and included in the scope of the engagement that could reasonably be expected to be relevant to the common needs of a broad range of user auditors in planning their audits of user entities' financial statements?

- Is the description prepared at a level of detail that could reasonably be expected to provide a broad range of user auditors with sufficient information to obtain an understanding of internal control in accordance with AU-C section 315? The description need not address every aspect of the service organization's processing or the services provided to user entities and need not be so detailed that it would potentially enable a reader to compromise security or other controls at the service organization.
- Is the description prepared in a manner that does not omit or distort information that might affect the decisions of a broad range of user auditors; for example, does the description contain any significant omissions or inaccuracies regarding processing of which the service auditor is aware?
- Does the description include relevant details of changes to the service organization's system during the period covered by the description when the description covers a period of time?
- Have the controls identified in the description actually been implemented?
- Are complementary user entity controls, if any, adequately described? In most cases, the control objectives stated in the description are worded so that they are capable of being achieved through the effective operation of controls implemented by the service organization alone. In some cases, however, the control objectives stated in the description cannot be achieved by the service organization alone because their achievement requires particular controls to be implemented by user entities. This may be the case when, for example, the control objectives are specified by a regulatory authority. When the description does include complementary user entity controls, the description separately identifies those controls along with the specific control objectives that cannot be achieved by the service organization alone. (Ref: par. .19(c))
- If the inclusive method has been used, does the description separately identify controls at the service organization and controls at the subservice organization? If the carve-out method is used, does the description identify the functions that are performed by the subservice organization? When the carve-out method is used, the description need not describe the detailed processing or controls at the subservice organization.

[Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

.A33 The service auditor's procedures to evaluate the fair presentation of management's description of the service organization's system may include the following:

- Considering the nature of the user entities and how the services provided by the service organization are likely to affect them; for example, the predominant types of user entities, and whether the user entities are regulated by government agencies
- Reading contracts with user entities to gain an understanding of the service organization's contractual obligations

- Observing procedures performed by service organization personnel
- Reviewing the service organization's policy and procedure manuals and other documentation of the system; for example, flowcharts and narratives
- Performing walkthroughs of transactions through the service organization's system

.A34 Paragraph .19(a) requires the service auditor to evaluate whether the control objectives stated in management's description of the service organization's system are reasonable in the circumstances. Considering the following questions may assist the service auditor in this evaluation:

- Have the control objectives stated in the description been specified by the service organization or by outside parties, such as regulatory authorities, a user group, a professional body, or others?
- Do the control objectives stated in the description and specified by the service organization relate to the types of assertions commonly embodied in the broad range of user entities' financial statements to which controls at the service organization could reasonably be expected to relate (for example, assertions about existence and accuracy that are affected by access controls that prevent or detect unauthorized access to the system)? Although the service auditor ordinarily will not be able to determine how controls at a service organization specifically relate to the assertions embodied in individual user entities' financial statements, the service auditor's understanding of the nature of the service organization's system, including controls, and the services being provided is used to identify the types of assertions to which those controls are likely to relate.
- Are the control objectives stated in the description and specified by the service organization complete? Although a complete set of control objectives can provide a broad range of user auditors with a framework to assess the effect of controls at the service organization on assertions commonly embodied in user entities' financial statements, the service auditor ordinarily will not be able to determine how controls at a service organization specifically relate to the assertions embodied in individual user entities' financial statements and cannot, therefore, determine whether control objectives are complete from the viewpoint of individual user entities or user auditors. It is the responsibility of individual user entities or user auditors to assess whether the service organization's description addresses the particular control objectives that are relevant to their needs. If the control objectives are specified by an outside party, including control objectives specified by law or regulation, the outside party is responsible for their completeness and reasonableness. (Ref: par. .19(a))

.A35 The service auditor's procedures to determine whether the system described by the service organization has been implemented may be similar to, and performed in conjunction with, procedures to obtain an understanding of that system. Other procedures that the service auditor may use in combination with inquiry of management and other service organization personnel include observation, inspection of records and other documentation, as well as reperformance of the manner in which transactions are processed through the system and controls are applied. (Ref: par. .19(b) and .20)

Obtaining Evidence Regarding the Design of Controls (Ref: par. .21)

.A36 The risks and control objectives identified in paragraph .21(a) encompass intentional and unintentional acts that threaten the achievement of the control objectives. (Ref: par. .21(a))

.A37 From the viewpoint of a user auditor, a control is suitably designed to achieve the control objectives stated in management's description of the service organization's system if individually or in combination with other controls, it would, when complied with satisfactorily, provide reasonable assurance that material misstatements are prevented, or detected and corrected. A service auditor, however, is not aware of the circumstances at individual user entities that would affect whether or not a misstatement resulting from a control deficiency is material to those user entities. Therefore, from the viewpoint of a service auditor, a control is suitably designed if individually or in combination with other controls, it would, when complied with satisfactorily, provide reasonable assurance that the control objective(s) stated in the description of the service organization's system are achieved.

.A38 A service auditor may consider using flowcharts, questionnaires, or decision tables to facilitate understanding the design of the controls.

.A39 Controls may consist of a number of activities directed at the achievement of various control objectives. Consequently, if the service auditor evaluates certain activities as being ineffective in achieving a particular control objective, the existence of other activities may allow the service auditor to conclude that controls related to the control objective are suitably designed to achieve the control objective.

Obtaining Evidence Regarding the Operating Effectiveness of Controls (Ref: par. .22–.27)

.A40 From the viewpoint of a user auditor, a control is operating effectively if individually or in combination with other controls, it provides reasonable assurance that material misstatements whether due to fraud or error are prevented, or detected and corrected. A service auditor, however, is not aware of the circumstances at individual user entities that would affect whether or not a misstatement resulting from a control deviation is material to those user entities. Therefore, from the viewpoint of a service auditor, a control is operating effectively if individually or in combination with other controls, it provides reasonable assurance that the control objectives stated in management's description of the service organization's system are achieved. Similarly, a service auditor is not in a position to determine whether any observed control deviation would result in a material misstatement from the viewpoint of an individual user entity. (Ref: par. .22)

.A41 Obtaining an understanding of controls sufficient to opine on the suitability of their design is not sufficient evidence regarding their operating effectiveness unless some automation provides for the consistent operation of the controls as they were designed and implemented. For example, obtaining information about the implementation of a manual control at a point in time does not provide evidence about operation of the control at other times. However, because of the inherent consistency of IT processing, performing procedures to determine the design of an automated control and whether it has been implemented may serve as evidence of that control's operating effectiveness, depending on the service auditor's assessment and testing of controls such as those over program changes. (Ref: par. .22)

.A42 A type 2 report that covers a period that is less than six months is unlikely to be useful to user entities and their auditors. If management's description of the service organization's system covers a period that is less than six months, the description may describe the reasons for the shorter period and the service auditor's report may include that information as well. Circumstances that may result in a report covering a period of less than six months include the following:

- The service auditor was engaged close to the date by which the report on controls is to be issued, and controls cannot be tested for operating effectiveness for a six month period.
- The service organization or a particular system or application has been in operation for less than six months.
- Significant changes have been made to the controls, and it is not practicable either to wait six months before issuing a report or to issue a report covering the system both before and after the changes. (Ref: par. .23)

.A43 Evidence about the satisfactory operation of controls in prior periods does not provide evidence of the operating effectiveness of controls during the current period. The service auditor expresses an opinion on the effectiveness of controls throughout each period; therefore, sufficient appropriate evidence about the operating effectiveness of controls throughout the current period is required for the service auditor to express that opinion for the current period. Knowledge of deviations observed in prior engagements may, however, lead the service auditor to increase the extent of testing during the current period. (Ref: par. .22)

.A44 Determining the effect of changes in the service organization's controls that were implemented during the period covered by the service auditor's report involves gathering information about the nature and extent of such changes, how they affect processing at the service organization, and how they might affect assertions in the user entities' financial statements. (Ref: par. .14(b) and .23)

.A45 Certain controls may not leave evidence of their operation that can be tested at a later date and, accordingly, the service auditor may find it appropriate to test the operating effectiveness of such controls at various times throughout the reporting period. (Ref: par. .22)

Using the Work of an Internal Audit Function

Obtaining an Understanding of the Internal Audit Function (Ref: par. .28)

.A46 An internal audit function may be responsible for providing analyses, evaluations, assurances, recommendations, and other information to management and those charged with governance. An internal audit function at a service organization may perform activities related to the service organization's internal control or activities related to the services and systems, including controls that the service organization provides to user entities.

.A47 The scope and objectives of an internal audit function vary widely and depend on the size and structure of the service organization and the requirements of management and those charged with governance. Internal audit function activities may include one or more of the following:

- Monitoring the service organization's internal control or the application processing systems. This may include controls relevant to the services provided to user entities. The internal audit function may be assigned specific responsibility for reviewing controls, monitoring their operation, and recommending improvements thereto.
- Examination of financial and operating information. The internal audit function may be assigned to review the means by which the service organization identifies, measures, classifies, and reports financial and operating information; to make inquiries about specific matters; and to perform other procedures including detailed testing of transactions, balances, and procedures.
- Evaluation of the economy, efficiency, and effectiveness of operating activities including nonfinancial activities of the service organization.
- Evaluation of compliance with laws, regulations, and other external requirements and with management policies, directives, and other internal requirements.

Using the Work of the Internal Audit Function (Ref: par .31–.32)

.A48 The nature, timing, and extent of the service auditor's procedures on specific work of the internal auditors will depend on the service auditor's assessment of the significance of that work to the service auditor's conclusions (for example, the significance of the risks that the controls tend to mitigate), the evaluation of the internal audit function, and the evaluation of the specific work of the internal auditors. Such procedures may include the following:

- Examination of items already examined by the internal auditors
- Examination of other similar items
- Observation of procedures performed by the internal auditors

Effect on the Service Auditor's Report (Ref: par. .33–.34)

.A49 The responsibility to report on management's description of the service organization's system and the suitability of the design and operating effectiveness of controls rests solely with the service auditor and cannot be shared with the internal audit function. Therefore, the judgments about the significance of deviations in the design or operating effectiveness of controls, the sufficiency of tests performed, the evaluation of identified deficiencies, and other matters affecting the service auditor's report are those of the service auditor. In making judgments about the extent of the effect of the work of the internal audit function on the service auditor's procedures, the service auditor may determine, based on risk associated with the controls and the significance of the judgments relating to them, that the service auditor will perform the work relating to some or all of the controls rather than using the work performed by the internal audit function.

.A50 In the case of a type 2 report, when the work of the internal audit function has been used in performing tests of controls, the service auditor's description of that work and of the service auditor's procedures with respect to that work may be presented in a number of ways, for example, (Ref: par. .34 and .52(o)(i))

- by including introductory material to the description of tests of controls indicating that certain work of the internal audit function was used in performing tests of controls.

- attribution of individual tests to internal audit.

Written Representations (Ref: par. .36–.39)

.A51 Written representations reaffirming the service organization's assertion about the effective operation of controls may be based on ongoing monitoring activities, separate evaluations, or a combination of the two. (Ref: par. .A12)

.A52 In certain circumstances, a service auditor may obtain written representations from parties in addition to management of the service organization, such as those charged with governance.

.A53 The written representations required by paragraph .36 are separate from and in addition to the assertion included in or attached to management's description of the service organization's system required by paragraph .09(c)(vii).

.A54 If the service auditor is unable to obtain written representations regarding relevant control objectives and related controls at the subservice organization, management of the service organization would be unable to use the inclusive method but could use the carve-out method.

.A55 In addition to the written representations required by paragraph .36, the service auditor may consider it necessary to request other written representations.

Other Information

.A56 The "other information" referred to in paragraphs .40–.41 may be the following:

- Information provided by the service organization and included in a section of the service auditor's type 1 or type 2 report, or
- Information outside the service auditor's type 1 or type 2 report included in a document that contains the service auditor's report. This other information may be provided by the service organization or by another party. (Ref: par. .40, .52(c)(ii)–(iii), and .53(c)(ii)–(iii))

.A57 If other information included in a document containing management's description of the service organization's system and the service auditor's report contains future-oriented information that cannot be reasonably substantiated, the service auditor may request that the information be removed or revised. (Ref: par. .41)

Documentation

.A58 Paragraph 57 of Statement on Quality Control Standards No. 8, *A Firm's System of Quality Control*, requires the firm to establish policies and procedures that address engagement performance, supervision responsibilities, and review responsibilities. The requirement to document who reviewed the work performed and the extent of the review, in accordance with the firm's policies and procedures addressing review responsibilities, does not imply a need for each specific working paper to include evidence of review. The requirement, however, means documenting what work was reviewed, who reviewed such work, and when it was reviewed. (Ref: par. .44)

Preparing the Service Auditor's Report

Content of the Service Auditor's Report (Ref: par. .52–.53)

.A59 Examples of service auditors' reports are presented in appendixes A–C and illustrative assertions by management of the service organization are presented in exhibit A.

.A60 The service organization's assertion may be presented in management's description of the service organization's system or may be attached to the description. (Ref: par. .52(e) and .53(e))

Use of the Service Auditor's Report (Ref: par. .52(p) and .53(o))

.A61 Paragraph .79 of section 101 requires that the use of a practitioner's report be restricted to specified parties when the criteria used to evaluate or measure the subject matter are available only to specified parties or appropriate only for a limited number of parties who either participated in their establishment or can be presumed to have an adequate understanding of the criteria. The criteria used for engagements to report on controls at a service organization are relevant only for the purpose of providing information about the service organization's system, including controls, to those who have an understanding of how the system is used for financial reporting by user entities and, accordingly, the service auditor's report states that the report and the description of tests of controls are intended only for use by management of the service organization, user entities of the service organization ("during some or all of the period covered by the report" for a type 2 report, and "as of the ending date of the period covered by the report" for a type 1 report), and their user auditors. (The illustrative service auditor's reports in appendix A illustrate language for a paragraph restricting the use of a service auditor's report.)

.A62 Paragraph .79 of section 101 indicates that the need for restriction on the use of a report may result from a number of circumstances, including the potential for the report to be misunderstood when taken out of the context in which it was intended to be used, and the extent to which the procedures performed are known or understood.

.A63 Although a service auditor is not responsible for controlling a service organization's distribution of a service auditor's report, a service auditor may inform the service organization of the following:

- A service auditor's type 1 report is not intended for distribution to parties other than the service organization, user entities of the service organization's system as of the end of the period covered by the service auditor's report, and their user auditors.
- A service auditor's type 2 report is not intended for distribution to parties other than the service organization, user entities of the service organization's system during some or all of the period covered by the service auditor's report, and their user auditors.

.A64 A user entity is also considered a user entity of the service organization's subservice organizations if controls at subservice organizations are relevant to internal control over financial reporting of the user entity. In such case, the user entity is referred to as an indirect or downstream user entity of the subservice organization. Consequently, an indirect or downstream user entity may be included in the group to whom use of the service auditor's report is restricted if controls at the service organization are relevant to internal control over financial reporting of such indirect or downstream user entity.

Description of the Service Auditor's Tests of Controls and the Results Thereof (Ref: par. .52(o)(ii))

.A65 In describing the service auditor's tests of controls for a type 2 report, it assists readers if the service auditor's report includes information about causative factors for identified deviations, to the extent the service auditor has identified such factors.

Modified Opinions (Ref: par. .55–.57)

.A66 Examples of elements of modified service auditor's reports are presented in appendix B.

Other Communication Responsibilities (Ref: par. .58)

.A67 Actions that a service auditor may take when he or she becomes aware of noncompliance with laws and regulations, fraud, or uncorrected errors at the service organization (after giving additional consideration to instances in which the service organization has not appropriately communicated this information to affected user entities, and the service organization is unwilling to do so) include the following:

- Obtaining legal advice about the consequences of different courses of action
- Communicating with those charged with governance of the service organization
- Disclaiming an opinion, modifying the service auditor's opinion, or adding an emphasis paragraph
- Communicating with third parties, for example, a regulator, when required to do so
- Withdrawing from the engagement

.A68

Appendix A: Illustrative Service Auditor's Reports

The following illustrative reports are for guidance only and are not intended to be exhaustive or applicable to all situations.

Example 1: Type 2 Service Auditor's Report

Independent Service Auditor's Report on a Description of a Service Organization's System and the Suitability of the Design and Operating Effectiveness of Controls

To: XYZ Service Organization

Scope

We have examined XYZ Service Organization's description of its [*type or name of*] system for processing user entities' transactions [*or identification of the function performed by the system*] throughout the period [*date*] to [*date*] (description) and the suitability of the design and operating effectiveness of controls to achieve the related control objectives stated in the description.

Service organization's responsibilities

On page XX of the description, XYZ Service Organization has provided an assertion about the fairness of the presentation of the description and suitability of the design and operating effectiveness of the controls to achieve the related control objectives stated in the description. XYZ Service Organization is responsible for preparing the description and for the assertion, including the completeness, accuracy, and method of presentation of the description and the assertion, providing the services covered by the description, specifying the control objectives and stating them in the description, identifying the risks that threaten the achievement of the control objectives, selecting the criteria, and designing, implementing, and documenting controls to achieve the related control objectives stated in the description.

Service auditor's responsibilities

Our responsibility is to express an opinion on the fairness of the presentation of the description and on the suitability of the design and operating effectiveness of the controls to achieve the related control objectives stated in the description, based on our examination. We conducted our examination in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform our examination to obtain reasonable assurance about whether, in all material respects, the description is fairly presented and the controls were suitably designed and operating effectively to achieve the related control objectives stated in the description throughout the period [*date*] to [*date*].

An examination of a description of a service organization's system and the suitability of the design and operating effectiveness of the service organization's controls to achieve the related control objectives stated in the description involves performing procedures to obtain evidence about the fairness of the presentation of the description and the suitability of the design and operating effectiveness of those controls to achieve the related control objectives stated in the description. Our procedures included assessing the risks that the description is not fairly presented and that the controls were not suitably designed or operating effectively to achieve the related control objectives stated in the description. Our procedures also included testing the operating effectiveness of those controls that we consider necessary to provide reasonable assurance that the related control objectives stated in the description were achieved. An examination engagement of this type also includes evaluating the overall presentation of the description and the suitability of the control objectives stated therein, and the suitability of the criteria specified by the service organization and described at page *[aa]*. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

Inherent limitations

Because of their nature, controls at a service organization may not prevent, or detect and correct, all errors or omissions in processing or reporting transactions [*or identification of the function performed by the system*]. Also, the projection to the future of any evaluation of the fairness of the presentation of the description, or conclusions about the suitability of the design or operating effectiveness of the controls to achieve the related control objectives is subject to the risk that controls at a service organization may become inadequate or fail.

Opinion

In our opinion, in all material respects, based on the criteria described in XYZ Service Organization's assertion on page [*aa*],

a. the description fairly presents the [*type or name of*] system that was designed and implemented throughout the period [*date*] to [*date*].

b. the controls related to the control objectives stated in the description were suitably designed to provide reasonable assurance that the control objectives would be achieved if the controls operated effectively throughout the period [*date*] to [*date*].

c. the controls tested, which were those necessary to provide reasonable assurance that the control objectives stated in the description were achieved, operated effectively throughout the period [*date*] to [*date*].

Description of tests of controls

The specific controls tested and the nature, timing, and results of those tests are listed on pages [*yy–zz*].

Restricted use

This report, including the description of tests of controls and results thereof on pages [*yy–zz*], is intended solely for the information and use of XYZ Service Organization, user entities of XYZ Service Organization's [*type or name of*] system during some or all of the period [*date*] to [*date*], and the independent auditors of such user entities, who have a sufficient understanding to consider it, along with other information including information about controls implemented by user entities themselves, when assessing the risks of material misstatements of user entities' financial statements. This report is not intended to be and should not be used by anyone other than these specified parties.

[*Service auditor's signature*]

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

[*Service auditor's city and state*]

Following is a modification of the scope paragraph in a type 2 service auditor's report if the description refers to the need for complementary user entity controls. (New language is shown in boldface italics):

> We have examined XYZ Service Organization's description of its [*type or name of*] system for processing user entities' transactions [*or identification of the function performed by the system*] throughout the period [*date*] to [*date*] (description) and the suitability of the design and operating effectiveness of controls to achieve the related control objectives stated in the description. ***The description indicates that certain control objectives specified in the description can be achieved only if complementary user entity controls contemplated in the design of XYZ Service Organization's controls are suitably designed and operating effectively, along with related controls at the service organization. We have not evaluated the suitability of the design or operating effectiveness of such complementary user entity controls.***

Following is a modification of the applicable subparagraphs of the opinion paragraph of a type 2 service auditor's report if the application of complementary user entity controls is necessary to achieve the related control objectives stated in the description of the service organization's system (New language is shown in boldface italics):

b. The controls related to the control objectives stated in the description were suitably designed to provide reasonable assurance that those control objectives would be achieved if the controls operated effectively throughout the period [*date*] to [*date*] ***and user entities applied the complementary user entity controls contemplated in the design of XYZ Service Organization's controls throughout the period [date] to [date]***.

c. The controls tested, which ***together with the complementary user entity controls referred to in the scope paragraph of this report, if operating effectively,*** were those necessary to provide reasonable assurance that the control objectives stated in the description were achieved, operated effectively throughout the period [*date*] to [*date*].

Following is a modification of the paragraph that describes the responsibilities of management of the service organization for use in a type 2 service auditor's report when the control objectives have been specified by an outside party. (New language is shown in boldface italics):

> On page XX of the description, XYZ Service Organization has provided an assertion about the fairness of the presentation of the description and suitability of the design and operating effectiveness of the controls to achieve the related control objectives stated in the description. XYZ Service Organization is responsible for preparing the description and for its assertion], including the completeness, accuracy, and method of presentation of the description and assertion, providing the services covered by the description, selecting the criteria, and designing, implementing, and documenting controls to achieve the related control objectives stated in the description. ***The control objectives have been specified by [name of party specifying the control objectives] and are stated on page [aa] of the description***.

Example 2: Type 1 Service Auditor's Report

Independent Service Auditor's Report on a Description of a Service Organization's System and the Suitability of the Design of Controls

To: XYZ Service Organization

Scope

We have examined XYZ Service Organization's description of its [*type or name of*] system for processing user entities' transactions [*or identification of the function performed by the system*] as of [*date*], and the suitability of the design of controls to achieve the related control objectives stated in the description.

Service organization's responsibilities

On page XX of the description, XYZ Service Organization has provided an assertion about the fairness of the presentation of the description and suitability of the design of the controls to achieve the related control objectives stated in the description. XYZ Service Organization is responsible for preparing the description and for its assertion, including the completeness, accuracy, and method of presentation of the description and the assertion, providing the services covered by the description, specifying the control objectives and stating them in the description, identifying the risks that threaten the achievement of the control objectives, selecting the criteria, and designing, implementing, and documenting controls to achieve the related control objectives stated in the description.

Service auditor's responsibilities

Our responsibility is to express an opinion on the fairness of the presentation of the description and on the suitability of the design of the controls to achieve the related control objectives stated in the description, based on our examination. We conducted our examination in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform our examination to obtain reasonable assurance, in all material respects, about whether the description is fairly presented and the controls were suitably designed to achieve the related control objectives stated in the description as of [*date*].

An examination of a description of a service organization's system and the suitability of the design of the service organization's controls to achieve the related control objectives stated in the description involves performing procedures to obtain evidence about the fairness of the presentation of the description of the system and the suitability of the design of the controls to achieve the related control objectives stated in the description. Our procedures included assessing the risks that the description is not fairly presented and that the controls were not suitably designed to achieve the related control objectives stated in the description. An examination engagement of this type also includes evaluating the overall presentation of the description and the suitability of the control objectives stated therein, and the suitability of the criteria specified by the service organization and described at page *[aa]*.

We did not perform any procedures regarding the operating effectiveness of the controls stated in the description and, accordingly, do not express an opinion thereon.

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

Inherent limitations

Because of their nature, controls at a service organization may not prevent, or detect and correct, all errors or omissions in processing or reporting transactions [*or identification of the function performed by the system*]. The projection to the future of any evaluation of the fairness of the presentation of the description, or any conclusions about the suitability of the design of the controls to achieve the related control objectives is subject to the risk that controls at a service organization may become ineffective or fail.

Opinion

In our opinion, in all material respects, based on the criteria described in XYZ Service Organization's assertion,

a. the description fairly presents the [*type or name of*] system that was designed and implemented as of [*date*], and

b. the controls related to the control objectives stated in the description were suitably designed to provide reasonable assurance that the control objectives would be achieved if the controls operated effectively as of [*date*].

Restricted use

This report is intended solely for the information and use of XYZ Service Organization, user entities of XYZ Service Organization's [*type or name of*] system as of [*date*], and the independent auditors of such user entities, who have a sufficient understanding to consider it, along with other information including information about controls implemented by user entities themselves, when obtaining an understanding of user entities information and communication systems relevant to financial reporting. This report is not intended to be and should not be used by anyone other than these specified parties.

[*Service auditor's signature*]

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

[*Service auditor's city and state*]

Following is a modification of the scope paragraph in a type 1 report if the description of the service organization's system refers to the need for complementary user entity controls. (New language is shown in boldface italics)

> We have examined XYZ Service Organization's description of its [type or name of] system (description) made available to user entities of the system for processing their transactions [or identification of the function performed by the system] as of [date], and the suitability of the design of controls to achieve the related control objectives stated in the description. ***The description indicates that certain complementary user entity controls must be suitably designed and implemented at user entities for related controls at the service organization to be considered suitably designed to achieve the related control objectives. We have not evaluated the suitability of the design or operating effectiveness of such complementary user entity controls.***

Following is a modification of the applicable subparagraph in the opinion paragraph of a type 1 report if the application of complementary user entity controls is necessary to achieve the related control objectives stated in management's description of the service organization's system (New language is shown in boldface italics):

> *b.* The controls related to the control objectives stated in the description were suitably designed to provide reasonable assurance that those control objectives would be achieved if the controls operated effectively as of [*date*] ***and user entities applied the complementary user entity controls contemplated in the design of XYZ Service Organization's controls as of [date].***

Following is a modification of the paragraph that describes management of XYZ Service Organization's responsibilities to be used in a type 1 report when the control objectives have been specified by an outside party. (New language is shown in boldface italics):

> On page XX of the description, XYZ Service Organization has provided an assertion about the fairness of the presentation of the description and suitability of the design of the controls to achieve the related control objectives stated in the description. XYZ Service Organization is responsible for preparing the description and assertion, including the completeness, accuracy, and method of presentation of the description and assertion, providing the services covered by the description, selecting the criteria, and designing, implementing, and documenting controls to achieve the related control objectives stated in the description. ***The control objectives have been specified by [name of party specifying the control objectives] and are stated on page [aa] of the description***.

.A69

Appendix B: Illustrative Modified Service Auditor's Reports

The following examples of modified service auditor's reports are for guidance only and are not intended to be exhaustive or applicable to all situations. They are based on the illustrative reports in appendix A.

Example 1: Qualified Opinion for a Type 2 Report—The Description of the Service Organization's System is Not Fairly Presented in All Material Respects

The following is an illustrative paragraph describing the basis for the qualified opinion. The paragraph would be inserted before the modified opinion paragraph. All other report paragraphs are unchanged.

Basis for qualified opinion

The accompanying description states on page [*mn*] that XYZ Service Organization uses operator identification numbers and passwords to prevent unauthorized access to the system. Based on inquiries of staff personnel and observation of activities, we have determined that operator identification numbers and passwords are employed in applications A and B but are not required to access the system in applications C and D.

Opinion

In our opinion, except for the matter described in the preceding paragraph, and based on the criteria described in XYZ Service Organization's assertion on page *[aa]*, in all material respects. . .

Example 2: Qualified Opinion—The Controls are Not Suitably Designed to Provide Reasonable Assurance That the Control Objectives Stated in the Description of the Service Organization's System Would be Achieved if the Controls Operated Effectively

The following is an illustrative paragraph describing the basis for the qualified opinion. The paragraph would be inserted before the modified opinion paragraph. All other report paragraphs are unchanged.

Basis for qualified opinion

As discussed on page [*mn*] of the accompanying description, from time to time, XYZ Service Organization makes changes in application programs to correct deficiencies or to enhance capabilities. The procedures followed in determining whether to make changes, in designing the changes, and in implementing them do not include review and approval by authorized individuals who are independent from those involved in making the changes. There also are no specified requirements to test such changes or provide test results to an authorized reviewer prior to implementing the changes. As a result the controls are not suitably designed to achieve the control objective, "Controls provide reasonable assurance that changes to existing applications are authorized, tested, approved, properly implemented, and documented."

Opinion

In our opinion, except for the matter described in the preceding paragraph, and based on the criteria described in XYZ Service Organization's assertion on page *[aa]*, in all material respects. . .

Example 3: Qualified Opinion for a Type 2 Report—The Controls Did Not Operate Effectively Throughout the Specified Period to Achieve the Control Objectives Stated in the Description of the Service Organization's System

The following is an illustrative paragraph describing the basis for the qualified opinion. The paragraph would be inserted before the modified opinion paragraph. All other report paragraphs are unchanged.

Basis for qualified opinion

XYZ Service Organization states in its description that it has automated controls in place to reconcile loan payments received with the various output reports. However, as noted on page [*mn*] of the description of tests of controls and results thereof, this control was not operating effectively throughout the period [*date*] to [*date*] due to a programming error. This resulted in the nonachievement of the control objective, "Controls provide reasonable assurance that loan payments received are properly recorded" throughout the period January 1, 20X1, to April 30, 20X1. XYZ Service Organization implemented a change to the program performing the calculation as of May 1, 20X1, and our tests indicate that it was operating effectively throughout the period May 1, 20X1, to December 31, 20X1.

Opinion

In our opinion, except for the matter described in the preceding paragraph, and based on the criteria described in XYZ Service Organization's assertion on page [*aa*], in all material respects. . . .

Example 4: Qualified Opinion—The Service Auditor is Unable to Obtain Sufficient Appropriate Evidence

The following is an illustrative paragraph describing the basis for the qualified opinion. The paragraph would be inserted before the modified opinion paragraph. All other report paragraphs are unchanged.

Basis for qualified opinion

XYZ Service Organization states in its description that it has automated controls in place to reconcile loan payments received with the output generated. However, electronic records of the performance of this reconciliation for the period from [*date*] to [*date*] were deleted as a result of a computer processing error and, therefore, we were unable to test the operation of this control for that period. Consequently, we were unable to determine whether the control objective, "Controls provide reasonable assurance that loan payments received are properly recorded" was achieved throughout the period [*date*] to [*date*].

Opinion

In our opinion, except for the matter described in the preceding paragraph, and based on the criteria described in XYZ Service Organization's assertion on page [*aa*], in all material respects. . .

.A70

Appendix C: Illustrative Report Paragraphs for Service Organizations That Use a Subservice Organization

Following are modifications of the illustrative type 2 report in example 1 of appendix A for use in engagements in which the service organization uses a subservice organization. (New language is shown in boldface italics; deleted language is shown by strikethrough.)

Example 1: Carve-Out Method

Scope

We have examined XYZ Service Organization's description of its system for processing user entities' transactions [*or identification of the function performed by the system*] throughout the period [*date*] to [*date*] (description) and the suitability of the design and operating effectiveness of controls to achieve the related control objectives stated in the description.

XYZ Service Organization uses a computer processing service organization for all of its computerized application processing. The description on pages [bb–cc] includes only the controls and related control objectives of XYZ Service Organization and excludes the control objectives and related controls of the computer processing service organization. Our examination did not extend to controls of the computer processing service organization.

All other report paragraphs are unchanged.

Example 2: Inclusive Method

Scope

We have examined XYZ Service Organization's ***and ABC Subservice Organization's*** description of ~~its~~ ***their*** [*type or name of*] system for processing user entities' transactions [*or identification of the function performed by the system*] throughout the period [*date*] to [*date*] (description) and the suitability of the design and operating effectiveness of ***XYZ Service Organization's and ABC Subservice Organization's*** controls to achieve the related control objectives stated in the description. ***ABC Subservice Organization is an independent service organization that provides computer processing services to XYZ Service Organization. XYZ Service Organization's description includes a description of ABC Subservice Organization's*** **[type or name of]** ***system used by XYZ Service Organization to process transactions for its user entities, as well as relevant control objectives and controls of ABC Subservice Organization.***

XYZ Service Organization's responsibilities

On page XX of the description, XYZ Service Organization ***and ABC Subservice Organization*** ~~has~~ ***have*** provided ~~an~~ ***their*** assertion***s*** about the fairness of the presentation of the description and suitability of the design and operating effectiveness of the controls to achieve the related control objectives stated in the description. XYZ Service Organization ***and ABC Subservice Organization are*** ~~is~~ responsible for preparing the description and assertion***s***, including the completeness, accuracy, and method of presentation of the description and assertion***s***, providing the services covered by the description, specifying the control objectives and stating them in the description, identifying the risks that threaten the achievement of the control objectives, selecting the criteria, and designing, implementing, and documenting controls to achieve the related control objectives stated in the description.

Inherent limitations

Because of their nature, controls at a service organization ***or subservice organization*** may not prevent, or detect and correct, all errors or omissions in processing or reporting transactions. Also, the projection to the future of any evaluation of the fairness of the presentation of the description or any conclusions about the suitability of the design or operating effectiveness of the controls to achieve the related control objectives is subject to the risk that controls at a service organization ***or subservice organization*** may become ineffective or fail.

Opinion

In our opinion, in all material respects, based on the criteria specified in XYZ Service Organization**'s and ABC Subservice Organization's** assertions on page [*aa*],

a. the description fairly presents ***XYZ Service Organization's*** ~~the~~ [*type or name of*] system ***and ABC Subservice Organization's*** **[*type or name of*] *system used by XYZ Service Organization to process transactions for its user entities* [*or identification of the function performed by the service organization's system*]** that ***were*** ~~was~~ designed and implemented throughout the period [*date*] to [*date*].

b. the controls related to the control objectives ***of XYZ Service Organization and ABC Subservice Organization*** stated in the description were suitably designed to provide reasonable assurance that the control objectives would be achieved if the controls operated effectively throughout the period [*date*] to [*date*].

c. the controls ***of XYZ Service Organization and ABC Subservice Organization that*** we tested, which were those necessary to provide reasonable assurance that the control objectives stated in the description were achieved, operated effectively throughout the period [*date*] to [*date*].

All other report paragraphs are unchanged.

.A71

Exhibit A: Illustrative Assertions by Management of a Service Organization

The assertion by management of the service organization may be included in management's description of the service organization's system or may be attached to the description. The following illustrative assertions are intended for assertions that are included in the description.

The following illustrative management assertions are for guidance only and are not intended to be exhaustive or applicable to all situations.

Example 1: Assertion by Management of a Service Organization for a Type 2 Report

XYZ Service Organization's Assertion

We have prepared the description of XYZ Service Organization's [*type or name of*] system (description) for user entities of the system during some or all of the period [*date*] to [*date*], and their user auditors who have a sufficient understanding to consider it, along with other information, including information about controls implemented by user entities of the system themselves, when assessing the risks of material misstatements of user entities' financial statements. We confirm, to the best of our knowledge and belief, that

a. the description fairly presents the [*type or name of*] system made available to user entities of the system during some or all of the period [*date*] to [*date*] for processing their transactions [*or identification of the function performed by the system*]. The criteria we used in making this assertion were that the description

   i. presents how the system made available to user entities of the system was designed and implemented to process relevant transactions, including

      (1) the classes of transactions processed.

      (2) the procedures, within both automated and manual systems, by which those transactions are initiated, authorized, recorded, processed, corrected as necessary, and transferred to the reports presented to user entities of the system.

      (3) the related accounting records, supporting information, and specific accounts that are used to initiate, authorize, record, process, and report transactions; this includes the correction of incorrect information and how information is transferred to the reports presented to user entities of the system.

      (4) how the system captures and addresses significant events and conditions, other than transactions.

      (5) the process used to prepare reports or other information provided to user entities' of the system.

      (6) specified control objectives and controls designed to achieve those objectives.

(7) other aspects of our control environment, risk assessment process, information and communication systems (including the related business processes), control activities, and monitoring controls that are relevant to processing and reporting transactions of user entities of the system.

ii. does not omit or distort information relevant to the scope of the [*type or name of*] system, while acknowledging that the description is prepared to meet the common needs of a broad range of user entities of the system and the independent auditors of those user entities, and may not, therefore, include every aspect of the [*type or name of*] system that each individual user entity of the system and its auditor may consider important in its own particular environment.

b. the description includes relevant details of changes to the service organization's system during the period covered by the description when the description covers a period of time.

c. the controls related to the control objectives stated in the description were suitably designed and operated effectively throughout the period [*date*] to [*date*] to achieve those control objectives. The criteria we used in making this assertion were that

i. the risks that threaten the achievement of the control objectives stated in the description have been identified by the service organization;

ii. the controls identified in the description would, if operating as described, provide reasonable assurance that those risks would not prevent the control objectives stated in the description from being achieved; and

iii. the controls were consistently applied as designed, including whether manual controls were applied by individuals who have the appropriate competence and authority.

Example 2: Assertion by Management of a Service Organization for a Type 1 Report

XYZ Service Organization's Assertion

We have prepared the description of XYZ Service Organization's [*type or name of*] system (description) for user entities of the system as of [*date*], and their user auditors who have a sufficient understanding to consider it, along with other information including information about controls implemented by user entities themselves, when obtaining an understanding of user entities' information and communication systems relevant to financial reporting. We confirm, to the best of our knowledge and belief, that

a. the description fairly presents the [*type or name of*] system made available to user entities of the system as of [*date*] for processing their transactions [*or identification of the function performed by the system*]. The criteria we used in making this assertion were that the description

i. presents how the system made available to user entities of the system was designed and implemented to process relevant transactions, including

(1) the classes of transactions processed.

(2) the procedures, within both automated and manual systems, by which those transactions are initiated, authorized, recorded, processed, corrected as necessary, and transferred to the reports presented to user entities of the system.

(3) the related accounting records, supporting information, and specific accounts that are used to initiate, authorize, record, process, and report transactions; this includes the correction of incorrect information and how information is transferred to the reports provided to user entities of the system.

(4) how the system captures and addresses significant events and conditions, other than transactions.

(5) the process used to prepare reports or other information provided to user entities of the system.

(6) specified control objectives and controls designed to achieve those objectives.

(7) other aspects of our control environment, risk assessment process, information and communication systems (including the related business processes), control activities, and monitoring controls that are relevant to processing and reporting transactions of user entities of the system.

ii. does not omit or distort information relevant to the scope of the [*type or name of*] system, while acknowledging that the description is prepared to meet the common needs of a broad range of user entities of the system and the independent auditors of those user entities, and may not, therefore, include every aspect of the [*type or name of*] system that each individual user entity of the system and its auditor may consider important in its own particular environment.

b. the controls related to the control objectives stated in the description were suitably designed as of [*date*] to achieve those control objectives. The criteria we used in making this assertion were that

i. the risks that threaten the achievement of the control objectives stated in the description have been identified by the service organization.

ii. the controls identified in the description would, if operating as described, provide reasonable assurance that those risks would not prevent the control objectives stated in the description from being achieved.

.A72

Exhibit B: Comparison of Requirements of Section 801, *Reporting On Controls at a Service Organization*, With Requirements of International Standard on Assurance Engagements 3402, *Assurance Reports on Controls at a Service Organization*

This analysis was prepared by the AICPA Audit and Attest Standards staff to highlight substantive differences between section 801, *Reporting on Controls at a Service Organization*, and International Standard on Assurance Engagements (ISAE) 3402, *Assurance Reports on Controls at a Service Organization*, and to explain the rationale for those differences. This analysis is not authoritative and is prepared for informational purposes only.

1. Intentional Acts by Service Organization Personnel

Paragraph .26 of this section requires the service auditor to investigate the nature and cause of any deviations identified, as does paragraph 28 of ISAE 3402. Paragraph .27 of this section indicates that if the service auditor becomes aware that the deviations resulted from intentional acts by service organization personnel, the service auditor should assess the risk that the description of the service organization's system is not fairly presented and that the controls are not suitably designed or operating effectively. The ISAE does not contain the requirement included in paragraph .27 of this section. The Auditing Standards Board (ASB) believes that information about intentional acts affects the nature, timing, and extent of the service auditor's procedures. Therefore, paragraph .27 provides follow-up action for the service auditor when he or she obtains information about intentional acts as a result of performing the procedures in paragraph .26 of this section.

Paragraph .36(c)(ii) of this section, which is not included in ISAE 3402, also requires the service auditor to request written representations from management that it has disclosed to the service auditor knowledge of any actual, suspected, or alleged intentional acts by management or the service organization's employees, of which it is aware, that could adversely affect the fairness of the presentation of management's description of the service organization's system or the completeness or achievement of the control objectives stated in the description.

2. Anomalies

Paragraph 29 of ISAE 3402 contains a requirement that enables a service auditor to conclude that a deviation identified in tests of controls involving sampling is not representative of the population from which the sample was drawn. This section does not include this requirement because of concerns about use of terms such as, "in the extremely rare circumstances" and "a high degree of certainty." These terms are not used in U.S professional standards and the ASB believes their introduction in this section could have unintended consequences. The ASB also believes that the deletion of this requirement will enhance examination quality because deviations identified by the service auditor in tests of controls involving sampling will be treated in the same manner as any other deviation identified by the practitioner, rather than as an anomaly.

3. Direct Assistance

Paragraph .35 of this section requires the service auditor to adapt and apply the requirements in paragraph .27 of AU-C section 610, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*, when the service auditor uses members of the service organization's internal audit function to provide direct assistance. Because AU-C section 610 provides for an auditor to use the work of the internal audit function in a direct assistance capacity, paragraph .35 of this section also provides for this. The International Standards on Auditing and the ISAEs do not provide for use of the internal audit function for direct assistance.

4. Subsequent Events

With respect to events that occur subsequent to the period covered by the description of the service organization's system up to the date of the service auditor's report, paragraph .42 of this section requires the service auditor to disclose in the service auditor's report, if not disclosed by management in its description, any event that is of such a nature and significance that its disclosure is necessary to prevent users of a type 1 or type 2 report from being misled. The ASB believes that information about such events could be important to user entities and their auditors. ISAE 3402 limits the types of subsequent events that would need to be disclosed in the service auditor's report to those that could have a significant effect on the service auditor's report.

Paragraph .43 of this section requires the service auditor to adapt and apply the guidance in AU-C section 560, *Subsequent Events and Subsequently Discovered Facts*, if, after the release of the service auditor's report, the service auditor becomes aware of conditions that existed at the report date that might have affected management's assertion and the service auditor's report had the service auditor been aware of them. The ISAE does not include a similar requirement. The ASB believes that, by analogy, AU-C section 560 provides needed guidance to a service auditor by presenting the various circumstances that could occur during the subsequent events period and the actions a service auditor should take.

5. Statement Restricting Use of the Service Auditor's Report

This section requires the service auditor's report to include a statement restricting the use of the report to management of the service organization, user entities of the service organization's system, and user auditors. The ASB believes that the unambiguous language in the restricted use statement prevents misunderstanding regarding who the report is intended for. Paragraphs .A61–.A62 of this section explain the reasons for restricting the use of the report. ISAE 3402 requires the service auditor's report to include a statement indicating that the report is intended only for user entities and their auditors, However, the ISAE does not require the inclusion of a statement restricting the use of the report to specified parties, although it does not prohibit the inclusion of restricted use language in the report.

6. Documentation Completion

Paragraph 50 of the ISAE requires the service auditor to assemble the documentation in an engagement file and complete the administrative process of assembling the final engagement file on a timely basis after the date of the service auditor's assurance report. Paragraph .49 of this section also requires the service auditor to assemble the engagement documentation in an engagement file and complete the administrative process of assembling the final engagement file on a timely basis, but also indicates that a timely basis is no later than 60 days following the service auditor's report release date. The ASB made this change to parallel the definition of *documentation completion date* in paragraph .06 of AU-C section 230, *Audit Documentation*.

7. Engagement Acceptance and Continuance

Paragraph .09 of this section establishes conditions for the acceptance and continuance of an engagement to report on controls at a service organization. One of the conditions is that management acknowledge and accept responsibility for providing the service auditor with written representations at the conclusion of the engagement. ISAE 3402 does not include this requirement as a condition of engagement acceptance and continuance.

8. Disclaimer of Opinion

If management does not provide the service auditor with certain written representations, paragraph 40 of ISAE 3402 requires the service auditor, after discussing the matter with management, to disclaim an opinion. In the same circumstances, paragraph .39 of this section requires the service auditor to take appropriate action, which may include disclaiming an opinion or withdrawing from the engagement.

Paragraphs .56–.57 of this section contain certain incremental requirements when the service auditor plans to disclaim an opinion.

9. Elements of the Section 801 Report That Are Not Required in the ISAE 3402 Report

Paragraphs .52–.53 of this section contain certain requirements regarding the content of the service auditor's report, which are incremental to those in ISAE 3402. These incremental requirements are included in paragraphs .52(c)(iii); .52(e)(iv); .52(i); and .52(k) for type 2 reports, and in paragraphs .53(c)(iii); .53(e)(iv); .53(j); and .53(k) for type 1 reports.

[Revised, December 2012, to reflect conforming changes necessary due to the issuance of SAS Nos. 122–126.]

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AT Appendix B

Other Attestation Publications

This listing identifies *other attestation publications* published by the AICPA that have been reviewed by the AICPA Audit and Attest Standards staff and are, therefore, presumed to be appropriate as defined in AT section 50, *SSAE Hierarchy*. Products may be obtained through www.cpa2biz.com.

AICPA Technical Questions and Answers

Q&A section 9500, *Attestation Engagements*

Current AICPA Attestation Risk Alerts

Service Organization Control Reports: Considerations for User and Service Auditors

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