

Governmental Audit Engagement Letter Considerations Related to the Effect of SAS Nos. 134-140

AICPA Statement on Auditing Standards (SAS) Nos. 134-140 (also referred to as the reporting suite of standards) made changes to the requirements and guidance for engagement letters. Those standards are generally effective for audits of fiscal periods ending on or after December 15, 2021. The AICPA Governmental Audit Quality Center (GAQC) is issuing this article in response to questions it has received from members on the implications of these new standards on engagement letters for audits performed in accordance with *Government Auditing Standards* and/or single audits performed under the *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance).

The 2021 edition of the AICPA Audit Guide, [Government Auditing Standards and Single Audits](#) (GAS-SA Guide), updated the engagement letter guidance in chapter 3, “Planning and Performing a Financial Statement Audit in Accordance With *Government Auditing Standards*,” and chapter 6, “Auditor Planning Considerations Under the Uniform Guidance,” for the implications of the new standards. Both chapters include updated examples of items the auditor may consider including in such letters, as applicable.

A few general reminders about engagement letter requirements before getting into the details of specific governmental considerations.

1. Agreeing upon the terms of the audit engagement with management of the audited entity reduces the risk of misunderstanding about the respective responsibilities of management and the auditor.
2. The auditor should agree upon the terms of the engagement with management or those charged with governance, as appropriate.
3. AU-C section 210, [Terms of Engagement](#) (which was revised by the reporting suite of standards), states that the objective of the auditor is to accept an audit engagement for a new or existing audit client only when the basis upon which it is to be performed has been agreed upon through (a) establishing whether the preconditions for an audit (defined in the standard) are present, and (b) confirming that a common understanding of the terms of the audit engagement exists between the auditor and management and, when appropriate, those charged with governance.
4. AU-C section 210 notes that to establish that the preconditions for an audit are present, the auditor should determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable.
5. The auditor should obtain the agreement of management that it acknowledges and understands its responsibilities as further outlined in AU-C section 210.

6. The agreed upon terms of the audit engagement should be documented in an engagement letter or other suitable form of written agreement.

The following includes a summary of the items to consider including in governmental audit engagement letters which are excerpted from the 2021 GAS-SA Guide. These examples are in addition to the general requirements in AU-C section 210 and the suggested items in paragraphs .A23-.A28 of AU-C Section 210. A good approach to updating your engagement letters for the new standards would be to compare your existing engagement letters to the two bulleted lists below, as applicable, to ensure that you are using the most up-to-date language.

Summary of Engagement Letter Guidance from Chapter 3 of the 2021 GAS-SA Guide Relevant to the Performance of the Audit In Accordance with *Government Auditing Standards*

The auditor may consider including the items below in the engagement letter when engaged to perform an audit of financial statements in accordance with *Government Auditing Standards*. Note that auditors may also wish to refer to the 2021 editions of the AICPA Audit and Accounting Guides, [State and Local Governments](#), and [Not-for-Profit Entities](#), for additional industry-specific engagement letter considerations for financial statement audits of those types of entities.

- A description of the financial statements to be audited and of the reports the auditor is expecting to prepare and issue
- The reporting period
- The auditing standards and requirements that will be followed (that is, (generally accepted auditing standards) and *Government Auditing Standards*)
- A description of management's responsibility for the following:
 - The preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework
 - Complying with applicable laws and regulations
 - Implementing systems designed to achieve compliance with applicable laws and regulations
 - Establishing and maintaining effective internal control to help ensure that appropriate goals and objectives are met, following laws and regulations, and ensuring that management and financial information is reliable and properly reported
 - Identifying and providing report copies of previous audits, attestation engagements, or other studies that directly relate to the objectives of the audit, including whether related recommendations have been implemented
 - Addressing the findings and recommendations of auditors, and for establishing and maintaining a process to track the status of such findings and recommendations

- Taking timely and appropriate steps to remedy fraud and noncompliance with provisions of laws, regulations, contracts, and grant agreements that the auditor reports
- A description of management and auditor responsibilities for additional information that accompanies the basic financial statements — for example, supplementary information and required supplementary information
- The following items when nonaudit services are to be performed:
 - Objectives of the nonaudit service
 - Services to be provided
 - Auditee's acceptance of its responsibilities (as described in paragraph 3.76 of *Government Auditing Standards*)
 - The auditor's responsibilities
 - Any limitations on the provisions of nonaudit services
- Pertinent information that, in the auditor's professional judgment, needs to be communicated to individuals contracting for or requesting the audit, and to those legislative committees, if any, that have ongoing oversight responsibilities for the audited entity when auditors perform the audit pursuant to a law or regulation
- Report distribution responsibilities, including which officials or organizations will receive the report and the steps to be taken to make the report available to the public when the audit organization is responsible for report distribution
- A statement that, subject to applicable laws and regulations, appropriate individuals, as well as audit documentation, will be made available upon request and in a timely manner to appropriate auditors and reviewers
- A statement that receipt of written representations related to management's responsibilities will be expected, along with written representations required by other AU-C sections

Summary of Guidance from Chapter 6 of the GAS-SA Guide Relevant to the Performance of a Single Audit

In addition to the matters communicated as part of the financial statement audit performed in accordance with *Government Auditing Standards* (as described above), the communication should include the planned work and level of assurance related to internal control over compliance and compliance with federal statutes, regulations, and the terms and conditions of federal awards necessary for an audit under the Uniform Guidance. Based on the requirements found in AU-C section 210 and in accordance with [AU-C section 935, Compliance Audits](#), the auditor should use professional judgment to adapt and apply the provisions in AU-C section 210 to meet the objective of a compliance audit. The items that may be included in the communication when performing an audit under the Uniform Guidance are as follows:

- The objective of an audit in accordance with the Uniform Guidance

- A description of management’s responsibility for (a) identifying all federal awards received and understanding and complying with the compliance requirements; (b) preparing the schedule of expenditures of federal awards (including noncash assistance received and notes) in accordance with Uniform Guidance requirements; (c) designing, implementing, and maintaining effective internal controls over compliance that provide reasonable assurance that the entity administers federal awards in compliance with the compliance requirements; (d) complying with federal laws, statutes, regulations, rules, and provisions of contracts or grant agreements of federal awards; (e) following up and taking corrective action on audit findings, including the preparation of a summary schedule of prior audit findings and a corrective action plan; and (f) submitting the reporting package and Data Collection Form
- A description of the auditor's responsibility in a compliance audit of major programs under the Uniform Guidance, including the determination of major programs, the consideration of internal control over compliance, and reporting responsibilities
- A statement that the objectives of the auditor are to obtain reasonable assurance about whether material noncompliance with the applicable compliance requirements occurred, whether due to fraud or error, and express an opinion on the entity's compliance based on the audit. State that reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS, Government Auditing Standards, and the Uniform Guidance will always detect material noncompliance when it exists. State that the risk of not detecting material noncompliance resulting from fraud is higher than for that resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. State that noncompliance with the compliance requirements is considered material if there is a substantial likelihood that, individually or in the aggregate, it would influence the judgment made by a reasonable user of the report on compliance about the entity's compliance with the requirements of the federal programs as a whole.
- A statement that, in performing an audit in accordance with GAAS, Government Auditing Standards, and the Uniform Guidance, the auditor's responsibilities are to
 - exercise professional judgment and maintain professional skepticism throughout the audit.
 - identify and assess the risks of material noncompliance, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the entity's compliance with compliance requirements subject to audit and performing such other procedures as the auditor considers necessary in the circumstances.
 - obtain an understanding of the entity's internal control over compliance relevant to the audit in order to design audit procedures that are appropriate in the circumstances and to test and report on internal control over compliance in accordance with the Uniform Guidance but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over compliance. Accordingly, no such opinion is expressed.

- A statement that the auditor is required to communicate with those charged with governance, regarding, among other matters, the planned scope and timing of the audit and any significant deficiencies and material weaknesses in internal control over compliance that the auditor identified during the audit
- A description of the additional reports required by the Uniform Guidance that the auditor is expected to prepare and issue, including any limitation on their use
- A statement that the supplementary schedule(s) to be considered in the audit include the schedule of expenditures of federal awards
- A statement that management will make the auditor aware of significant contractor relationships in which the contractor is responsible for program compliance (so that the auditor can determine if additional procedures on contractor records will be necessary—see chapter 12, "Audit Considerations of Pass-Through Entities and Subrecipients," of the GAS-SA Guide)
- A statement that the parties to whom audit documentation will be made available upon request include federal agencies and the U.S. Government Accountability Office