



HUD Potpourri of Topics



Audit Guide – General Guidance

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- Provide auditor requirements to perform specific procedures to enable an opinion on compliance
- Reports are the primary tool for HUD management in evaluating the program
- Although the Guide is mandatory for all for-profit entities it is *“not intended to cover all situations that may exist or replace auditor judgment of audit work required to meet GAAS and/or GAGAS”* *“...Suggested audit procedures contained herein might not cover all circumstances ...”* *The Auditor should use professional judgment to tailor the procedures so that the audit objectives may be achieved.”*



- *“...auditors must address all applicable compliance requirements in this guide.” If the auditor determines that certain procedures will not be performed, the rationale for the exclusion must be explained in detail and documented in support of the audit’s report, and an appropriate qualification to the auditor’s opinion may be required.”*



- Auditor should ensure that the audit procedures to be used is complete and applicable. If additional requirements are identified or requirements are not applicable to a certain period, procedures should be adjusted accordingly and documented. Federal rules, regulations, and other guidance should be followed and procedures should be modified to test current compliance. **Examples include the mortgagee letters or housing notices.**

General Audit Guidance con't

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- Audits must still file data collection forms on file AFS in accordance with A-133
- Management letters must be sent submitted directly to the HUD office providing funding/services to the auditee. When reporting through an electronic system is available, management letter s/b included in the filing. When electronic filing is not available, letter s/b sent to field office in hardcopy format
- Audit should determine the program office responsible

Use of Guide for A-133 Audits

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- Guide shall be used for program-specific audits of NFP sponsors. Paragraph 235(a) states *“When an auditor decides to perform a program-specific audit, the auditor should contact the Office of Inspector General of the Federal agency to determine whether such a guide is available. When a current program-specific audit guide is available, the auditor shall follow GAGAS and the guide when performing a program-specific audit.”*

Use of Guide for A-133 Audits con't

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- Engagement letter s/b modified to state that the auditor shall comply with the requirements of Handbook 2000.04.
- Letter should also state that the auditor must follow section 235 of A-133 and the illustrative reporting of chapter 2 of the Guide must be modified to conform to A-133

Audit Approach and Scope



- Opine on compliance
- Assess controls over compliance
- Report on IC
- Materiality at program level

HUD

GAGAS
(Yellowbook)

- Competence
- Independence
- Report on IC
- Report on compliance
- Focus on AFS materiality
- findings

GAAS

Engagement Letter

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- Audit performed in accordance with GAAS, GAGAS and Guide
- Date report will be delivered to auditee
- Government access to workpapers, including making copies of all documentation
- Illegal acts must be brought to the attention of management, even if inconsequential.
- Signing engagement letter gives auditor permission to make OIG contact for potential fraud

Engagement Letter, con't

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АНАСРА

- Electronic submission to REAC is client's responsibility
- Auditor engagement to perform AUP may be included in this letter or separate letter
- Description of scope of audit report contents and that report will meet requirements

Engagement Letter, con't

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АНАСРА

- Permission for successor auditor to review previous auditor workpapers & to discuss any matters
- List of client information to be supplied by client and expected delivery date
 - It is auditee's responsibility to ensure compliance with reporting requirements and conditions stated in engagement letter are met. Extensions on due dates will not be granted.
- Delays caused by the auditee should become the basis of an audit finding.

Fair Housing

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- Following guidance applies
 - Handbook 8004.1
 - Consolidated Civil Rights Monitoring Requirements For Section 8
 - 24 CFR Parts 1 and 8 and Part 100
 - Applies to all housing with exception of certain Indian tribes receiving HUD assistance



Audit Guide Chapter 2-1

“When performing tests of compliance requirements contained in Chapter 4, the IA should report on fair housing and nondiscrimination. Where the HUD-assisted activity is nonmajor, fair housing reporting should be included in the auditor's report on non-major HUD-assisted programs. Where the HUD-assisted activity is major, the auditor's report on specific requirements applicable to fair housing should be separate (Example E) from the auditor's opinion on compliance with specific requirements applicable to major programs.”

A-133 Program-Specific Audits – Par .200(c)

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- Program-specific election if:
 - Amounts are expended on only one program
 - **Program's laws, regulations, or grant agreements do not require AFS**
 - Follow paragraph .235
 - May not be elected for R&D unless all funds expended by one agency or same agency & pass-through entity

IN SHORT MOST HUD PROGRAMS DO NOT QUALIFY FOR PROGRAM-SPECIFIC TREATMENT

A-133 Part 7 Programs Not In Supplement

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- A-133 par .500(d)(3) states that programs not covered in the CS should use the 14 types of compliance requirements as a guide for testing programs

- Activities Allowed/Unallowed
- Allowable Costs/Cost Principles
- Cash Management
- Davis-Bacon Act
- Eligibility
- Equipment and Real Prop Mgmt
- Matching, Level of Effort Earmarking
- Period of Availability
- Procurement
- Program Income
- Real Property Acquisition
- Reporting
- Subrecipient Monitoring
- Special Tests & Provisions

A-133 Part 7 Programs Not In Supplement, con't

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- Auditor must determine applicable compliance requirements
- Focus should be on the 14 types of requirements listed in the previous slide
- Focus is on compliance requirements that could have a direct and material effect on the major program
- GAGAS may add additional responsibilities

A-133 Part 7 Programs Not In Supplement, con't

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- Auditor should address the following questions:
 - Program objectives, procedures and compliance requirements
 - Requirements that could have a direct and material effect
 - Subject to testing by the auditor
 - Into which of the 14 requirements does the compliance area pertain to?
 - For Special Tests and Provisions – what are objectives and procedures?

A-133 Part 7 Programs Not In Supplement, con't

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- Item 1 – Program Objectives, Procedures and Compliance Requirements
 - Discuss program with entity or Agency
 - Review contract and grant agreements
 - Review the CFDA
 - **Program-specific audit guide issued by OIG**
 - Consider other guidance

A-133 Part 7 Programs Not In Supplement, con't

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- Which compliance requirements are direct and material?
 - GAGAS requires that AFS be free of errors due to noncompliance
 - A-133 requires compliance at the program level (just like the HUD Audit Guide)
 - Result in questioned costs
 - Large part of program (\$ materiality)
 - Agency would take action (think small amounts of surplus cash)

A-133 Part 7 Programs Not In Supplement, con't

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- Which compliance requirements are subject to testing?
 - Practical to test
 - Objective criteria available
 - Where and objective can that supports opinion
 - Testing adds value (For example, permits agency to take action or warns agency)



Use of Reserve for Replacement Accounts in Restructured Mark-to-Market(M2M) Properties

- Specifies requirements governing use of Reserve for Replacements in M2M projects
- Other information governing the R4R is to be used on these projects

Purpose of the Notice

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- Reference Handbook 4350.1 for general guidance
- Owners of M2M projects are required to use R4R as the primary source of funding for capitalized expenses
 - MAHRA requires HUD to fund reserve accounts during restructuring for 20 years
 - Negotiated plan established monthly contributions to reserve account & surplus cash thereafter for not payments
- These notes represent statutorily prescribed debt expected to be repaid

Requirements for Use of R4R in M2M

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- Restructuring agreement required owner to rehab, maintain adequate reserves and maintain the project in decent, safe condition
- HUD required owners to establish R4R for 20 year period – adequate reserves are a key component process
- R4R must be first source to fund capital replacements

Requirements for Use of R4R in M2M, con't

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АНАСРА

- Owner must evaluate project condition and determine
 - Capital repair or replacement items necessary
 - Estimate of deposits to be sufficient to meet needs
- Final term sheet was given to owner that showed these amounts
- Once approved it became part of the terms and conditions of the M2M agreement

Requirements for Use of R4R in M2M, con't

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- Establishing the reserve was a critical component of underwriting and were sized specifically to meet requirements
- MAHRA limited restructuring notes to *“amount the PAE reasonably expects to be repaid based on objective criteria such as cash flow...”*
- Therefore HUD and owner must determine the anticipated reasonable and necessary operating expenses for a project

Requirements for Use of R4R in M2M, con't

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- Requirement for M2M debt to be repayable
- Specifically, statute intends that operating income is utilized for underwritten purpose
- Determination that M2M debt can be reasonable expected to repaid is important to IRS considerations as “real debt”
- M2M debt is exempt from section 7872 of the IRS Code
- In summary rents, operating expenses and R4R funding were negotiated and agreed to by owner and HUD

Restricted Use of Operating Income

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АНАСРА

- Operating income restricted for use on normal operating expenses, including R4R deposits
- Excludes capital repairs as defined in the 20-year schedule
- Must follow definition of surplus cash

Insufficient Reserve for Replacements

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- If reserve amounts are considered insufficient, HUD will consider an owner's request to:
 - Use operating income to for specific capital items
 - Increase the monthly reserve amount due to unexpected event. However, such an request is an exception to the general rule
- Such requests must be made to local project manager and include the basis for the request and supporting documentation
- Effective immediately



Reserve for Replacements

Handbook 4350.1 Chapter 4

Applicability

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- HUD-insured, formerly coinsured and HUD-held mortgages
- Applies to Section 202 and Section 162 Direct Loan programs, including 801 and 811 projects
- Reserve required for all projects except rehabs where mortgage does not exceed \$200,000
- Follow regulatory agreement

Regulatory Agreements

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- Shall establish account in guaranteed account
- Monthly payments
- Under control of mortgagee
- Disbursements made for:
 - Replacements
 - Repairs
 - Curing defaults or,
 - Any other purpose allowed by commissioner

Mortgagee's Certificates

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АНАСРА

- Begins with first payment toward amortization
- Monthly deposit of $1/12$ of yearly amount
- Withdrawn by permission
- Funds in guaranteed amounts
- US obligations are also acceptable

Economic Life of Project & Improvements

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- Improvements gradually decrease in economic value over time.
- Economic life is usually less than physical life of a project due to inability to generate a profit
- Economic life can never exceed physical life

Estimating Economic Life

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- Factors to be used are:
 - Economic background of community
 - Relationship between the property and the environment
 - Architectural design and style and likelihood of obsolescence
 - Trends in neighborhood
 - Workmanship
 - Physical condition and probable cost of maintenance

End of Useful Life of Improvements

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АНАСРА

- Building is at end of useful life when it is incapable of generating sufficient income to offset expenses and provide returns
- At that point building is at “shell” value
- Many projects underwritten with 40 year mortgages and 55 year useful lives
- Reserve is not intended to provide for sufficient money to replace all facilities but to provide a ready source to defray costs

Categories of Components

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- Items considered to be capital and eligible for reimbursement from R4R. Includes:
 - Major appliances, sinks tubs, countertops, doors
 - Major roof repairs, major plumbing, major HVAC
 - Repaving, complete exterior painting or siding
 - Extensive sprinkler repairs

Categories of Components, con't

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- Items that are routine maintenance
 - Repainting of interior areas (may be separate painting reserve)
 - Range burners, bibs, oven components
 - Dwelling HVAC
 - Minor roof, paving and gutter repairs
 - Purchase of maintenance tools and minor office equipment
 - Fire extinguishers

Adequacy of Reserve

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- Owners should review periodically and project future needs
- Deposits may be adjusted for needs – contact HUD to authorize
- Maybe made in conjunction with rent increases
- Recommended Minimum Thresholds
 - Initially established monthly deposit X 144
 - At least \$1,000 per unit

Adjusting the Reserve

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- The minimum is **THE MINIMUM**.
Increases for
 - Physical condition
 - Location
 - Imminent capital needs or replacements
 - Types and composition of units
 - Project size
 - Urban vs. Rural

Suspension of Reserve Payments

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- Older projects with seasoned mortgage may have payments suspended
- Considered a privilege for good physical condition
 - Maintain minimum threshold
 - R4R is invested and interest is retained
 - Good inspection scores
 - Same owners
 - Not under Section 8 with exceptions

Withdrawals

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- Newly built or rehabed should not need withdrawals
- Use insurance or warranties
- 223(f) projects may be required to withdraw
- Requests in writing with a description of work done or to be done
- Large withdrawals (\$20,000 or more than 20% of balance s/b discussed with field office
- If reimbursement, include copies of invoices (may require bids. Explain when lowest bidder is not selected
- Requests s/b made more often than quarterly and in same fiscal year of expenditure and preferably 60 days prior to year end.

HUD Approvals

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- Inspections of work not required for less than \$20,000



HUD Accounting for Capital Advances



Regulatory Agreement

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- Note and mortgage bear no interest
- Security for the advance for the required payment into the R4R and for all other obligations of mortgagor, the mortgagor assigns all rights to income
- Violations of the Regulatory Agreement, may, upon written notice, by HUD be determined to be default

Regulatory Agreement

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АНАСРА

- Upon default HUD may apply the following remedies:
 - Take possession of the project or take action to enforce any rights of mortgagor but ensure compliance
 - Collect all rents and charges for project operations
 - Declare the whole of indebtedness due and payable
 - Apply to court for specific performance under the agreement

Mortgage Note and Other Provisions

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- Notes are deemed paid and discharged without interest if the NPO meets certain stipulations (primarily housing a target audience)
- Note not otherwise due and payable due to default
- If note is not forgiven, interest is due and payable, although interest may be forgiven at HUD's discretion
- NPO also signs a Use Agreement
- See example language

Main Issues to Consider

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- How should it be reported?
 - Exchange (when to report revenue)
 - Contribution (conditional or unconditional)
 - Liability
- If reported as a contribution or liability should interest be accrued as a contribution or liability or not reported until payable?
- What disclosures should be included?

What is Seen in Practice?

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- Much diversity in reporting
 - Few report as exchange
 - Some report as a conditional contributions with associated liability
 - Some report as an unconditional contribution (following SFAS No. 116 paragraph 22)
 - Interest accrual is mixed. It depends on interpretation of FASB 5 reasonably possible, but less than probable (instances of this occurring are rare)

What is Seen in Practice

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- Some report liability at inception with interest accruing over life of loan
 - *Note: If conditions are met and the loan is forgiven, both principal and interest to be recorded as extinguishment or contribution.*
- Some account for both loan and interest as a conditional contribution
- Others do not account for interest under the theory that the likelihood is remote



- FASB Statement No. 5 – *Accounting for Contingencies*
- FASB Statement No. 116 – *Accounting for Contributions*
- FASB Statement No. 125 – *Accounting for Transfers and Servicing of Financial Assets and Extingishment of Liabilities*
- FASB Statement No. 6 – *Elements of Financial Statements*

HUD as Primary Financial Statement User

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- HUD has accepted financial statements with all treatments in REAC filings
- No expressed preference
- Must be consistent

Key Issues to Consider

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- Record as exchange, contribution or liability?
 - If recorded as exchange – when should revenue be recorded?
 - Commencement
 - Building completion
 - Over life of project
 - If a contribution – conditional or unconditional?
- If contribution or liability, when should interest be recognized, if any?
- Financial statement disclosures

FASB 116 paragraph 22

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- Hinges on when conditions are substantially met for a future event
- Conditional promise is unconditional if the possibility that the condition will not be met is remote
- Transfers of assets with a conditional promise to contribute shall be accounted for as a refundable advance until conditions are substantially met

Other FASB Considerations

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- Concepts No. 6 defines liabilities as *“probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services in the future”*
- FASB No. 5, paragraph 8 – loss contingencies can be accrued if it is probable that a liability has been incurred and the amount can be reasonably estimated.



- Task Force concluded
 - No support for any preferred methodology exists
 - Transactions for capital advances are not “one size fits all”. Reporting should be consistent with actual agreements
 - Capital advance transactions do not fit into one conceptual framework
 - Diversity will continue to exist

Conclusions, con't

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- Relevant terms of the HUD capital advance, including but not limited to
 - The amount of the initial advance
 - The amount outstanding at the B/S date
 - Events that trigger noncompliance, and therefore repayment of the advance
 - The date on which advance is forgiven
 - Nature of penalties and interest
- Financial reporting treatment of principle and interest
- If presented in consolidated statements, same level of detail w/o regard to materiality



- Capital advance was primary funding vehicle – disclose total advance o/s (all)
- What is policy for interest expense (all)
- Prepayment requirements and discharge date (all)
- Other operating requirements (all)
- Conditions for default (all)
- Repayment is other than remote (all)



- Treatment as a contribution is appropriate and is recorded as a restricted contribution (contribution)
- How is restriction accounted for (contribution)
- Amortization of deferred revenue and amount of deferred asset on the books as the B/S date



SAS 118-120 Update

Required supplementary information
and other information accompanying
audited financial statements



- Discuss the following recently issued SASs:
 - SAS No 118, *Other Information in Documents Containing Audited Financial Statements*
 - SAS No 119, *Supplementary Information in Relation to the Financial Statements as a Whole*
 - SAS No 120, *Required Supplementary Information*



SAS No. 118

*Other Information in Documents
Containing Audited Financial
Statements*

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- Effective for audits of financial statements for periods beginning on or after 12/15/2010 (Early application is permitted)
- Supersedes AU 550 and (along with SAS No. 119) AU 551



- OI = Financial and nonfinancial information that is included in a document containing audited financial statements and the auditor's report thereon, excluding required supplementary information
- Eliminates the distinction between OI that is in an auditor submitted vs client prepared document

Type Of Other Information

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- Reports by management or governance
- Financial summaries
- Employment data
- Planned Capital Expenditures
- Financial Ratios
- Officer data
- Does not include press releases, info from analyst briefings, entity website data

Documents Subject to SAS 118

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АНАСРА

- *Documents containing audited financial statements*
 - 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.
- SAS also may be applied, adapted as necessary in the circumstances, to other documents to which the auditor, at management's request, devotes attention



- Make arrangements with management or those charged with governance to obtain the OI prior to the report release date
- Read the OI that the auditor is aware of in order to identify *material inconsistencies* with the AFS
- Communicate with governance the auditor's responsibility for OI and any procedures performed as well as the results

Inconsistencies Before Report Date

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АНАСРА

- If MATERIAL inconsistency is identified prior to report release date and management refuses to make the revision:
 - Include an explanatory paragraph in the auditor's report
 - Withhold the auditor's report
 - Withdraw if possible
 - Communicate with governance

Inconsistencies Subsequent to Report Date

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- When revision of the AFS is necessary due to OI, auditor should apply relevant requirements in Section 561
- If management agrees to revision, then procedures may include reviewing steps taken by management to ensure that users are notified of need for revision

Inconsistencies Subsequent to Report Date, con't

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АНАСРА

- If the auditor becomes aware of a *material misstatement of fact*, discuss with management
 - After discussion – request management to consult and then consider the advice received
 - Notify those charged with governance

Material Misstatement of Fact

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- Discuss with management
- If differences still exist – consult with a qualified third party, legal counsel and determine if there is a material misstatement
- Notify governance if there is a misstatement and adjust opinion



SAS No. 119

*Supplementary Information in Relation
to the Financial Statements as a Whole*

АНАСРА

SAS No. 119

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- Effective for audits of financial statements for periods beginning on or after 12/15/2010 (early application is permitted)
- Supersedes (along with SAS No. 118) AU 551

Scope of the Statement

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- Addresses auditor's responsibility when engaged to report on supplementary info presented outside of the basic statements
- May also apply to RSI

Supplementary Information

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- Information presented outside the basic AFS, excluding RSI that is not considered necessary for presentation per GAAP
- May be presented in documents containing AFS or may be separated

Basic Requirements

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- In order to opine on whether SI is fairly stated in relation to the financial statements as a whole that the auditor should determine that all of the following conditions are met:
 - The SI was derived from, and relates directly to, the underlying accounting and other records used to prepare the f/s
 - The SI relates to the same period as the f/s
 - The f/s were audited, and the auditor served as the principal auditor in that engagement

Basic Requirements, con't

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- Neither an adverse opinion nor a disclaimer of opinion was issued on the f/s
- The SI will accompany the entity's AFS or such AFS will be made readily available by the entity

Required Procedures, con't

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- Auditor must obtain agreement with management that it acknowledges responsibility for:
 - Preparation of SI in accordance with criteria
 - Provide written representations
 - Include in the report on SI with any document that contains SI
 - Present SI with AFS or to make the AFS readily available to intended users of SI no later than the SI issue date

Required Procedures

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АНАСРА

- In addition to procedures performed during the f/s audit, in order to provide an IRT opinion, the auditor performs the following procedures (using the same materiality level as used during the f/s audit):
 - Inquire of management about the purpose of the SI and the criteria used by management to prepare the supplementary information (FRF, regulator criteria, contractual, other)
 - Determine whether the form and content of the SI complies with the applicable criteria

Required Procedures, con't

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АНАСРА

- Obtain an understanding about the methods of preparing the SI and determine whether the methods of preparing the SI have changed from those used in the prior period and, if the methods have changes, the reasons for such changes
- Compare and reconcile the SI to the underlying accounting and other records used in preparing the f/s or the f/s themselves

Required Procedures, con't

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- Inquire of management about any significant assumptions or interpretations underlying the measurement or presentation of the SI
- Evaluate the appropriateness and completeness of the SI, considering the results of the procedures performed and other knowledge obtained during the audit of the f/s
- Obtain written representations from management
- No responsibility for subsequent events on SI. Other subsequent event responsibility remains the same

Required Procedures, con't

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- Procedures are less than would be required for opinion on a stand-alone basis
- Materiality similar to AFS
- May also perform subsequent events or inquires of client's lawyer

Letter of Representations

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- Obtain written representations
 - Acknowledging responsibility for presentation
 - Believes the SI is presented fairly in accordance with criteria
 - Methods and measurement are consistent with prior period
 - Significant assumptions
 - When SI is not included with AFS, management will make the AFS available to users



- When the SI is presented with the AFS, the auditor reports on SI either:
 - In an explanatory paragraph in the report on the AFS
 - In a separate report
- For qualified opinions on AFS that effect the SI, include a statement that except for the effects of qualification, such SI is fairly stated
- If the SI is not presented with the AFS, then the auditor reports separately on the SI

Reporting con't

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АНАСРА

- When auditor's report is adverse or disclaimed, auditor is precluded from issuing an opinion on SI. Auditor may withdraw or report must state that it is not possible to opine
- If misstated, discuss with management
- When reporting separately on the SI, the report includes a reference to the report on the AFS (date of that report, nature of opinion expressed, and any report modifications)
- See revised language

Reporting con't

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АНАСРА

- If adverse opinion or disclaimer on AFS, the auditor can issue a report on SI stating that it is inappropriate to express an opinion on it
- Report on SI is not dated earlier than when procedures are completed
- Report may be “restricted use”



SAS No. 120

Required Supplementary Information



- Effective for audits of financial statements for periods beginning on or after 12/15/2010 (early application is permitted)
- Supersedes AU 558



- RSI

- Information that a designated accounting standard setter requires to accompany an entity's basic f/s
- RSI is not part of the basic f/s
- A designated accounting standard setter considers the information to be an essential part of the financial reporting for placing the basic f/s in an appropriate operational, economic, or historical context
- Authoritative guidelines for the methods of measurement and presentation of the information have been established



- Required procedures
 - Inquire of management about the methods of preparing the information including:
 - Whether it has been measured and presented in accordance with prescribed guidelines
 - Whether methods of measurement or presentation have changed from those used in the prior period and the reasons for any such changes and
 - Whether there were any significant assumptions or interpretations underlying the measurement or presentation of the information



- Compare the information for consistency with
 - Management's responses to the inquiries
 - The basic f/s, and
 - Other knowledge obtained during the audit of the basic f/s
- Obtain written reps from management



- Include an explanatory paragraph in the auditor's report on the f/s referring to the RSI. Different language is required based on:
 - The RSI is included and the auditor has applied all of the required procedures
 - The RSI is omitted
 - Some RSI is missing and some is presented in accordance with the prescribed guidelines
 - The auditor has identified material departures from the prescribed guidelines
 - The auditor is unable to complete the required procedures
 - The auditor has unresolved doubts about whether the RSI is presented in accordance with prescribed guidelines



- Authoritative Auditing Standards for non-issuers (SASs) as of June 1 are available at <http://www.aicpa.org/Research/Standards/Auditattest/pages/SAS.aspx>
- Other authoritative standards (SSARSs, SQCSs, SSAEs) are also available on the AICPA website