



*Statement on  
Auditing Standards*

May 2019  
134

*Issued by the Auditing Standards Board*

**Auditor Reporting and Amendments, Including Amendments  
Addressing Disclosures in the Audit of Financial Statements**

*(AICPA, Professional Standards, AU-C sec. 701;*

- *Supersedes the following sections of Statement on Auditing Standards [SAS] No. 122, Statements on Auditing Standards: Clarification and Recodification, as amended:*
  - *Section 700, Forming an Opinion and Reporting on Financial Statements [AICPA, Professional Standards, AU-C sec. 700]*
  - *Section 705, Modifications to the Opinion in the Independent Auditor's Report [AICPA, Professional Standards, AU-C sec. 705]*
  - *Section 706, Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report [AICPA, Professional Standards, AU-C sec. 706]*
- *Amends the following sections of SAS No. 122, as amended:*
  - *Section 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards [AICPA, Professional Standards, AU-C sec. 200]*
  - *Section 210, Terms of Engagement [AICPA, Professional Standards, AU-C sec. 210]*
  - *Section 220, Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards [AICPA, Professional Standards, AU-C sec. 220]*
  - *Section 230, Audit Documentation [AICPA, Professional Standards, AU-C sec. 230]*

- **Section 240, Consideration of Fraud in a Financial Statement Audit [AICPA, Professional Standards, AU-C sec. 240]**
- **Section 260, The Auditor’s Communication With Those Charged With Governance [AICPA, Professional Standards, AU-C sec. 260]**
- **Section 300, Planning an Audit [AICPA, Professional Standards, AU-C sec. 300]**
- **Section 315, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement [AICPA, Professional Standards, AU-C sec. 315]**
- **Section 320, Materiality in Planning and Performing an Audit [AICPA, Professional Standards, AU-C sec. 320]**
- **Section 330, Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained [AICPA, Professional Standards, AU-C sec. 330]**
- **Section 450, Evaluation of Misstatements Identified During the Audit [AICPA, Professional Standards, AU-C sec. 450]**
- **Section 510, Opening Balances — Initial Audit Engagements, Including Reaudit Engagements [AICPA, Professional Standards, AU-C sec. 510]**
- **Section 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures [AICPA, Professional Standards, AU-C sec. 540]**
- **Section 600, Special Considerations — Audits of Group Financial Statements [Including the Work of Component Auditors], as amended [AICPA, Professional Standards, AU-C sec. 600]**
- **Section 910, Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country**
- **Amends SAS No. 132, The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern [AICPA, Professional Standards, AU-C sec. 570]**

**Note: Possible Effects of Ongoing ASB Projects on SAS No. 134**

## **Other Information**

*As of the issuance date of this SAS, the ASB is in the process of deliberating proposed SAS The Auditor's Responsibilities Relating to Other Information Included in Annual Reports (OI SAS). Because the proposed OI SAS is not yet finalized, SAS No. 134 has been issued without the references to the proposed OI SAS that were included in the exposure draft of SAS No. 134. Once the OI SAS is issued as a final standard, conforming amendments will be made to SAS No. 134 to reflect the final OI SAS.*

*The proposed OI SAS is expected, when issued as a final standard, to have the same effective date as SAS No. 134.*

*[Recently issued standards](#) can be viewed on the AICPA's website.*

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The Auditing Standards Board gratefully acknowledges the contributions of Charles E. Landes in the development of this Statement on Auditing Standards.

*Note: Statements on Auditing Standards are issued by the Auditing Standards Board, the senior technical body of the AICPA designated to issue pronouncements on auditing matters. The “Compliance With Standards Rule”(ET sec. 1.310.001)<sup>1</sup> of the AICPA Code of Professional Conduct requires compliance with these standards in an audit of a nonissuer.*

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<sup>1</sup> All ET sections can be found in AICPA *Professional Standards*.

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## **AU-C Section 700**

### ***Forming an Opinion and Reporting on Financial Statements***

#### **Introduction**

##### **Scope of This Section**

**.01** This section addresses the auditor's responsibility to form an opinion on the financial statements. It also addresses the form and content of the auditor's report issued as a result of an audit of financial statements.

**.02** This section applies to an audit of a complete set of general purpose financial statements and is written in that context.

**.03** This section is not applicable when the auditor is forming an opinion and reporting on financial statements of employee benefit plans subject to the Employee Retirement Income Security Act of 1974 (ERISA). In such circumstances, Statement on Auditing Standards (SAS) *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA\** applies.

**.04** Section 705, *Modifications to the Opinion in the Independent Auditor's Report*, and section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*, of this SAS address how the form and content of the auditor's report are affected when the auditor expresses a modified opinion (a qualified opinion, an adverse opinion, or a disclaimer of opinion) or includes an emphasis-of-matter paragraph or other-matter paragraph in the auditor's report.

**.05** This section does not require the communication of key audit matters. Section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, of this SAS addresses the auditor's responsibility to communicate key audit matters when the auditor is engaged to do so.

**.06** AU-C section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*,<sup>†</sup> addresses special considerations when financial statements are prepared in accordance with a special purpose framework.<sup>1</sup> AU-C section 805, *Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*, addresses special considerations relevant to an audit of a single

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\* Statement on Auditing Standards (SAS) *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA* is expected to be issued as a final SAS in the second half of 2019.

<sup>†</sup> All AU-C sections can be found in AICPA *Professional Standards*.

<sup>1</sup> See AU-C section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, for a definition of *special purpose framework*.

financial statement or of a specific element, account, or item of a financial statement. (Ref: par. .A1–.A2)

**.07** The requirements of this section promote consistency and comparability in auditor reporting. Consistency in the auditor’s report, when the audit has been conducted in accordance with generally accepted auditing standards (GAAS), promotes credibility in the marketplace by making more readily identifiable those audits that have been conducted in accordance with recognized standards. Consistency also helps promote users’ understanding and identification of unusual circumstances when they occur.

### **Effective Date**

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

### **Objectives**

**.09** The objectives of the auditor are to do the following:

- a.* Form an opinion on the financial statements based on an evaluation of the audit evidence obtained, including evidence obtained about comparative financial statements or comparative financial information.
- b.* Express clearly the opinion on the financial statements through a written report. (Ref. par. .A3)

### **Definitions**

**.10** For purposes of GAAS, the following terms have the meanings attributed as follows:

**Comparative financial statements.** A complete set of financial statements<sup>2</sup> for one or more prior periods included for comparison with the financial statements of the current period.

**Comparative information.** Prior period information presented for purposes of comparison with current period amounts or disclosures that is not in the form of a complete set of financial statements. Comparative information includes prior period information presented as condensed financial statements or summarized financial information.

**Condensed financial statements.** Historical financial information<sup>3</sup> that is presented in less detail than a complete set of financial statements, in accordance with an appropriate financial reporting framework. Condensed financial statements may be separately presented as unaudited financial information or may be presented as comparative information.

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<sup>2</sup> See AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, for a definition of *financial statements*.

<sup>3</sup> Paragraph .14 of AU-C section 200 defines the term *historical financial information*.

**General purpose financial statements.** Financial statements prepared in accordance with a general purpose framework. (Ref. par. .A4)

**General purpose framework.** A financial reporting framework designed to meet the common financial information needs of a wide range of users.

**Unmodified opinion.** The opinion expressed by the auditor when the auditor concludes that the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.<sup>4</sup>

**.11** Reference to *financial statements* in this section means a complete set of general purpose financial statements. The requirements of the applicable financial reporting framework determine the presentation, structure, and content of the financial statements and what constitutes a complete set of financial statements.

## Requirements

### Forming an Opinion on the Financial Statements

**.12** The auditor should form an opinion on whether the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. (Ref: par. .A5)

**.13** In order to form that opinion, the auditor should conclude whether the auditor has obtained reasonable assurance<sup>5</sup> about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. That conclusion should take into account the following: (Ref. par. .A6)

- a. The auditor's conclusion, in accordance with AU-C section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, about whether sufficient appropriate audit evidence has been obtained<sup>6</sup>
- b. The auditor's conclusion, in accordance with AU-C section 450, *Evaluation of Misstatements Identified During the Audit*, about whether uncorrected misstatements are material, individually or in the aggregate<sup>7</sup>
- c. The evaluations required by paragraphs .14–.17

**.14** The auditor should evaluate whether the financial statements are prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework. This

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<sup>4</sup> Paragraph .14 of AU-C section 200 defines the term *applicable financial reporting framework*.

<sup>5</sup> Paragraph .14 of AU-C section 200 defines the term *reasonable assurance*.

<sup>6</sup> Paragraph .28 of AU-C section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

<sup>7</sup> Paragraph .11 of AU-C section 450, *Evaluation of Misstatements Identified during the Audit*.

evaluation should include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments. (Ref: par. .A7–.A9)

**.15** In particular, in view of the requirements of the applicable financial reporting framework, the auditor should evaluate whether

- a. the financial statements appropriately disclose the significant accounting policies selected and applied. In making this evaluation, the auditor should consider the relevance of the accounting policies to the entity and whether they have been presented in an understandable manner. (Ref: par. .A10)
- b. the accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate.
- c. the accounting estimates made by management are reasonable.
- d. the information presented in the financial statements is relevant, reliable, comparable, and understandable. In making this evaluation, the auditor should consider whether all required information has been included, and whether such information is appropriately classified, aggregated or disaggregated, and presented. (Ref: par. .A11)
- e. the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements. (Ref: par. .A12)
- f. the terminology used in the financial statements, including the title of each financial statement, is appropriate.

**.16** The auditor's evaluation about whether the financial statements achieve fair presentation should also include consideration of the following: (Ref: par. .A13–.A15)

- a. The overall presentation, structure, and content of the financial statements
- b. Whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation (Ref: par. .A16)

**.17** The auditor should evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework. (Ref: par. .A17–.A20)

### **Form of Opinion**

**.18** The auditor should express an unmodified opinion when the auditor concludes that the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.

**.19** The auditor should modify the opinion in the auditor's report, in accordance with section 705 of this SAS, in the following circumstances:

- a. The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are materially misstated.
- b. The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

**.20** If the auditor concludes that the financial statements do not achieve fair presentation, the auditor should discuss the matter with management and, depending on how the matter is resolved, should determine whether it is necessary to modify the opinion in the auditor's report in accordance with section 705 of this SAS. (Ref: par. .A21–.A22)

### **Auditor's Report**

**.21** The auditor's report should be in writing. (Ref: par. .A23–.A24)

### *Auditor's Report for Audits Conducted in Accordance With GAAS*

#### *Title*

**.22** The auditor's report should have a title that clearly indicates that it is the report of an independent auditor. (Ref: par. .A25)

#### *Addressee*

**.23** The auditor's report should be addressed, as appropriate, based on the circumstances of the engagement. (Ref: par. .A26)

#### *Auditor's Opinion*

**.24** The first section of the auditor's report should include the auditor's opinion and should have the heading "Opinion."

**.25** The "Opinion" section of the auditor's report should also do the following: (Ref: par. .A27–.A29)

- a. Identify the entity whose financial statements have been audited.
- b. State that the financial statements have been audited.
- c. Identify the title of each statement that the financial statements comprise.
- d. Refer to the notes.
- e. Specify the dates of or periods covered by each financial statement that the financial statements comprise.

**.26** When expressing an unmodified opinion on financial statements, the auditor's opinion should state that, in the auditor's opinion, the accompanying financial statements present fairly, in

all material respects, [...] in accordance with [*the applicable financial reporting framework*]. (Ref: par. .A17 and .A30–.A33)

**.27** The auditor’s opinion should identify the applicable financial reporting framework and its origin. (Ref: par. .A34)

*Basis for Opinion*

**.28** The auditor’s report should include a section, directly following the “Opinion” section, with the heading “Basis for Opinion,” that does the following: (Ref. par. .A35)

- a. States that the audit was conducted in accordance with generally accepted auditing standards and identifies the United States of America as the country of origin of those standards (Ref. par. .A36–.A37)
- b. Refers to the section of the auditor’s report that describes the auditor’s responsibilities under GAAS
- c. Includes a statement that the auditor is required to be independent of the entity and to meet the auditor’s other ethical responsibilities, in accordance with the relevant ethical requirements relating to the audit (Ref. par. .A38–.A39)
- d. States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor’s opinion

*Going Concern*

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

*Key Audit Matters*

**.30** When the auditor is engaged to communicate key audit matters, the auditor should do so in accordance with section 701 of this SAS. (Ref. par. .A40)

*Responsibilities of Management for the Financial Statements*

**.31** The auditor’s report should include a section with the heading “Responsibilities of Management for the Financial Statements.”

**.32** This section of the auditor’s report should describe management’s responsibility for the following:

- a. The preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error (Ref: par. .A41)

- b. When required by the applicable financial reporting framework, the evaluation of whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern [*for the time period set by the applicable financial reporting framework, as applicable*].

**.33** The description about management's responsibility for the financial statements in the auditor's report should not reference a separate statement by management about such responsibilities, even if such a statement is included in a document containing the auditor's report. (Ref: par. .A42)

*Auditor's Responsibilities for the Audit of the Financial Statements*

**.34** The auditor's report should include a section with the heading "Auditor's Responsibilities for the Audit of the Financial Statements."

**.35** This section of the auditor's report should do the following: (Ref. par. .A43)

- a. State that the objectives of the auditor are to
  - i. obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and (Ref: par. .A44)
  - ii. issue an auditor's report that includes the auditor's opinion.
- b. 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 will always detect a material misstatement when it exists. (Ref. par. .A45)
- c. State that the risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- d. State that misstatements are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users made on the basis of these financial statements.<sup>8</sup> (Ref. par. .A46)

**.36** The "Auditor's Responsibilities for the Audit of the Financial Statements" section of the auditor's report should further describe an audit by stating that, in performing an audit in accordance with GAAS, the auditor's responsibilities are to:

- a. Exercise professional judgment and maintain professional skepticism throughout the audit.
- b. Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive

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<sup>8</sup> Paragraph .02 of AU-C section 320, *Materiality in Planning and Performing an Audit*.

to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.

- c. Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, no such opinion is expressed.

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

- d. Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- e. Conclude whether, in the auditor's judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time.

**.37** The "Auditor's Responsibilities for the Audit of the Financial Statements" section of the auditor's report should also state that the auditor is required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that the auditor identified during the audit.

#### *Other Reporting Responsibilities*

**.38** If the auditor addresses other reporting responsibilities in the auditor's report on the financial statements that are in addition to the auditor's responsibility under GAAS, these other reporting responsibilities should be addressed in a separate section in the auditor's report with the heading "Report on Other Legal and Regulatory Requirements" or another heading that is appropriate to the content of the section. (Ref: par. .A47-.A48)

**.39** If the auditor's report contains a separate section that addresses other reporting responsibilities, the requirements of paragraphs .22-.37 of this section should be included under a section with the heading "Report on the Audit of the Financial Statements." The "Report on Other Legal and Regulatory Requirements" should follow the "Report on the Audit of the Financial Statements." (Ref: par. .A49)

#### *Signature of the Auditor*

**.40** The auditor's report should include the manual or printed signature of the auditor's firm. (Ref: par. .A50-.A52)

*Auditor's Address*

**.41** The auditor's report should name the city and state where the auditor's report is issued. (Ref: par. .A53)

*Date of the Auditor's Report*

**.42** The auditor's report should be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements, including evidence of the following: (Ref. par. .A54)

- a. All the statements and disclosures that the financial statements comprise have been prepared.
- b. Management has asserted that it has taken responsibility for those financial statements. (Ref: par. .A55–.A57)

***Auditor's Report for Audits Conducted in Accordance With Both GAAS and Another Set of Auditing Standards***

**.43** Paragraph .28 requires that the auditor's report state that the audit was conducted in accordance with GAAS and identify the United States of America as the country of origin of those standards. However, an auditor may indicate that the audit was also conducted in accordance with another set of auditing standards (for example, International Standards on Auditing [ISAs] or *Government Auditing Standards*). The auditor should not refer to having conducted an audit in accordance with another set of auditing standards in addition to GAAS unless the audit was conducted in accordance with both sets of standards in their entirety. (Ref: par. .A58)

**.44** When the auditor's report refers to both GAAS and another set of auditing standards, the auditor's report should identify the other set of auditing standards as well as its origin.

***Auditor's Report for Audits Conducted in Accordance With the Standards of the PCAOB and GAAS When the Audit Is Not Within the Jurisdiction of the PCAOB***

**.45** When conducting an audit of financial statements in accordance with the standards of the PCAOB and the audit is not within the jurisdiction of the PCAOB, the auditor is required to also conduct the audit in accordance with GAAS. In such circumstances, when the auditor refers to the standards of the PCAOB in addition to GAAS in the auditor's report, the auditor should use the form of report required by the standards of the PCAOB, amended to state that the audit was also conducted in accordance with GAAS. (Ref: par. .A59–.A65)

**Comparative Financial Statements and Comparative Information**

**.46** Comparative financial statements may be required by the applicable financial reporting framework, or management may elect to provide such information. When comparative financial statements are presented, the auditor's report should refer to each period for which financial statements are presented and on which an audit opinion is expressed. (Ref: par. .A66–.A67)

**.47** When expressing an opinion on all periods presented, a continuing auditor should update the report on the financial statements of one or more prior periods presented on a comparative basis with those of the current period. The auditor's report on comparative financial statements should not be dated earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to support the opinion for the most recent audit. (Ref: par. .A68–.A69)

**.48** If comparative information is presented but not covered by the auditor's opinion, the auditor should clearly indicate in the auditor's report the character of the auditor's work, if any, and the degree of responsibility the auditor is taking. (Ref: par. .A70–.A71)

**.49** If comparative information is presented and the entity requests the auditor to express an opinion on all periods presented, the auditor should consider whether the information included for the prior periods contains sufficient detail to constitute a fair presentation in accordance with the applicable financial reporting framework. (Ref: par. .A72)

### ***Audit Procedures***

**.50** The auditor should perform the procedures required by paragraphs .51–.53 if comparative financial statements or comparative information is presented for the prior periods.

**.51** The auditor should determine whether the comparative financial statements or comparative information has been presented in accordance with the relevant requirements, if any, of the applicable financial reporting framework.

**.52** The auditor should evaluate the following:

- a.* Whether the comparative financial statements or comparative information agrees with the amounts and other disclosures presented in the prior period or, when appropriate, has been restated for the correction of a material misstatement or adjusted for the retrospective application of an accounting principle
- b.* Whether the accounting policies reflected in the comparative financial statements or comparative information are consistent with those applied in the current period or, if there have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed<sup>9</sup>

**.53** If the auditor becomes aware of a possible material misstatement in the comparative financial statements or comparative information while performing the current period audit, the auditor should perform such additional audit procedures as are necessary in the circumstances to obtain sufficient appropriate audit evidence to determine whether a material misstatement exists. If the auditor audited the prior period's financial statements and becomes aware of a material misstatement in those financial statements, the auditor should also follow the relevant requirements of AU-C section 560, *Subsequent Events and Subsequently Discovered Facts*. If the prior period

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<sup>9</sup> See AU-C section 708, *Consistency of Financial Statements*.

financial statements are restated, the auditor should determine that the comparative financial statements or comparative information agrees with the restated financial statements.

**.54** As required by AU-C section 580, *Written Representations*, the auditor should request written representations for all periods referred to in the auditor's opinion. The auditor also should obtain a specific written representation regarding any restatement made to correct a material misstatement in a prior period that affects the comparative financial statements. (Ref: par. .A73)

**.55** When reporting on prior period financial statements in connection with the current period's audit, if the auditor's opinion on such prior period financial statements differs from the opinion the auditor previously expressed, the auditor should disclose the following matters in an emphasis-of-matter or other-matter paragraph, in accordance with section 706 of this SAS:

- a. The date of the auditor's previous report
- b. The type of opinion previously expressed
- c. The substantive reasons for the different opinion
- d. That the auditor's opinion on the amended financial statements is different from the auditor's previous opinion (Ref: par. .A74)

***Prior Period Financial Statements Audited by a Predecessor Auditor***

**.56** If the financial statements of the prior period were audited by a predecessor auditor, and the predecessor auditor's report on the prior period's financial statements is not reissued,<sup>10</sup> in addition to expressing an opinion on the current period's financial statements, the auditor should state the following in an other-matter paragraph:<sup>11</sup>

- a. That the financial statements of the prior period were audited by a predecessor auditor
- b. The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefore
- c. The nature of an emphasis-of-matter paragraph or other-matter paragraph included in the predecessor auditor's report, if any
- d. The date of that report

**.57** If the auditor concludes that a material misstatement exists that affects the prior period financial statements on which the predecessor auditor had previously reported without modification, the auditor should follow the communication requirements in AU-C section 510,

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<sup>10</sup> Paragraphs .19–.20 of AU-C section 560, *Subsequent Events and Subsequently Discovered Facts*.

<sup>11</sup> See section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*, of this SAS.

*Opening Balances — Initial Audit Engagements, Including Reaudit Engagements.*<sup>12</sup> If the prior period financial statements are restated, and the predecessor auditor agrees to issue a new auditor's report on the restated financial statements of the prior period, the auditor should express an opinion only on the current period. (Ref: par. .A75)

### ***Prior Period Financial Statements Not Audited***

**.58** When current period financial statements are audited and presented in comparative form with financial statements for the prior period for which a compilation or review was performed, and the report on the prior period is not reissued, the auditor should include an other-matter paragraph<sup>13</sup> in the current period auditor's report that includes the following with respect to the prior period:

- a. The service performed in the prior period
- b. The date of the report on that service
- c. A description of any material modifications noted in that report
- d. For a review engagement, a statement that the service was substantially less in scope than an audit and does not provide the basis for the expression of an opinion on the financial statements as a whole (Ref: par. .A76)
- e. For a compilation engagement, a statement that no opinion or other form of assurance is expressed on the financial statements (Ref: par. .A77)

**.59** If the prior period financial statements were not audited, reviewed, or compiled, the financial statements should be clearly marked to indicate their status, and the auditor's report should include an other-matter paragraph to indicate that the auditor has not audited, reviewed, or compiled the prior period financial statements and that the auditor assumes no responsibility for them. (Ref: par. .A78)

### **Information Presented in the Financial Statements**

**.60** Information that is not required by the applicable financial reporting framework but is nevertheless presented as part of the basic financial statements should be covered by the auditor's opinion if it cannot be clearly differentiated. (Ref: par. .A79–.A80)

## **Application and Other Explanatory Material**

### **Scope of This Section (Ref par. .06)**

**.A1** AU-C section 800 also addresses the auditor's responsibilities when the auditor is reporting on financial statements prepared in accordance with a special purpose framework and is required

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<sup>12</sup> Paragraphs .12–.13 of AU-C section 510, *Opening Balances — Initial Audit Engagements, Including Reaudit Engagements*.

<sup>13</sup> See section 706 of this SAS.

by law or regulation to use a specific layout, form, or wording of the auditor's report. When reporting on financial statements prepared in accordance with a general purpose framework, and law or regulation requires a specific layout, form, or wording of the auditor's report, the auditor may adapt and apply the requirements in section 800.

**.A2** Other AU-C sections that also contain reporting requirements include, but are not limited to, the following:

- AU-C section 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements*
- AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*
- AU-C section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*
- AU-C section 730, *Required Supplementary Information*
- AU-C section 810, *Engagements to Report on Summary Financial Statements*
- AU-C section 910, *Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country*

## **Objectives**

### ***Considerations Specific to Governmental Entities (Ref: par. .09)***

**.A3** For audits of governmental entities, the objectives of a financial statement audit are often broader than forming and expressing an opinion on the financial statements. Paragraph .A47 discusses the auditor's other reporting responsibilities.

## **Definitions**

### ***General Purpose Financial Statements***

#### ***Considerations Specific to Governmental Entities (Ref: par. .10)***

**.A4** For audits of governmental entities, the term *general purpose financial statements*, in the context of this section, would be considered or referred to as basic financial statements using the terms in the governmental entity's applicable financial reporting framework.

### **Forming an Opinion on the Financial Statements (Ref. par. .12)**

**.A5** As described in AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, a financial reporting framework is a set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements.

***Considerations Specific to Governmental Entities (Ref: par. .13)***

**.A6** For most state or local governmental entities, the applicable financial reporting framework is based on multiple reporting units and, therefore, requires the presentation of financial statements for the governmental entity's activities in various reporting units. Consequently, a reporting unit, or aggregation of reporting units, of the governmental entity represents an opinion unit to the auditor. In the context of this section, the auditor is responsible for forming an opinion on the financial statements for each opinion unit within a governmental entity.

***Qualitative Aspects of the Entity's Accounting Practices (Ref: par. .14)***

**.A7** Management makes a number of judgments about the amounts and disclosures in the financial statements.

**.A8** AU-C section 260, *The Auditor's Communication With Those Charged With Governance*, contains a discussion of the qualitative aspects of accounting practices.<sup>14</sup> In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgments. The auditor may conclude that the cumulative effect of a lack of neutrality, together with the effect of uncorrected misstatements, causes the financial statements as a whole to be materially misstated. Indicators of a lack of neutrality that may affect the auditor's evaluation of whether the financial statements as a whole are materially misstated include the following:

- The selective correction of misstatements brought to management's attention during the audit (for example, correcting misstatements with the effect of increasing reported earnings but not correcting misstatements that have the effect of decreasing reported earnings)
- Possible management bias in the making of accounting estimates

**.A9** AU-C section 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*, addresses possible management bias in making accounting estimates. Indicators of possible management bias, themselves, do not constitute misstatements for purposes of drawing conclusions on the reasonableness of individual accounting estimates. They may, however, affect the auditor's evaluation of whether the financial statements as a whole are free from material misstatement.

***Accounting Policies Appropriately Disclosed in the Financial Statements (Ref: par. .15a)***

**.A10** In evaluating whether the financial statements appropriately disclose the significant accounting policies selected and applied, the auditor's consideration may include matters such as the following:

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<sup>14</sup> The appendix "Qualitative Aspects of Accounting Practices," of AU-C section 260, *The Auditor's Communication With Those Charged With Governance*.

## *Forming an Opinion and Reporting on Financial Statements*

- Whether the financial statements include all disclosures related to the significant accounting policies that are required by the applicable financial reporting framework
- Whether the information about the significant accounting policies that has been disclosed is relevant and therefore reflects how the recognition, measurement, and presentation criteria in the applicable financial reporting framework have been applied to classes of transactions, account balances, and disclosures in the financial statements in the particular circumstances of the entity's operations and its environment
- The clarity with which the significant accounting policies have been presented

*Information Presented in the Financial Statements Is Relevant, Reliable, Comparable, and Understandable (Ref: par. .15d)*

**.A11** Evaluating the understandability of the financial statements may include consideration of whether the information in the financial statements is presented in a manner that facilitates users' ability to identify necessary information. This may include whether the disclosures are appropriately labeled and cross-referenced.

*Disclosure of the Effect of Material Transactions and Events on the Information Conveyed in the Financial Statements (Ref: par. .15e)*

**.A12** It is common for financial statements prepared in accordance with a general purpose framework to present an entity's financial position, results of operations, and cash flows. Evaluating whether, in view of the applicable financial reporting framework, the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the entity's financial position, results of operations, and cash flows may include consideration of such matters as the following:

- The extent to which the information in the financial statements is relevant and specific to the circumstances of the entity
- Whether the disclosures are adequate to assist the intended users in understanding the following:
  - The nature and extent of the entity's assets and liabilities arising from transactions or events that do not meet the criteria for recognition (or the criteria for derecognition) established by the applicable financial reporting framework
  - The methods used and the assumptions and judgments made, and changes to them, that affect amounts presented or otherwise disclosed, including relevant sensitivity analyses

*Evaluating Whether the Financial Statements Achieve Fair Presentation (Ref: par. .16)*

**.A13** Some financial reporting frameworks acknowledge explicitly or implicitly the concept of fair presentation. As noted in AU-C section 200, a *fair presentation financial reporting*

*framework*<sup>15</sup> not only requires compliance with the requirements of the framework but also acknowledges explicitly or implicitly that it may be necessary for management to provide disclosures beyond those specifically required by the framework.

**.A14** The auditor's evaluation about whether the financial statements achieve fair presentation, considering both presentation and disclosure, is a matter of professional judgment. This evaluation takes into account such matters as the facts and circumstances of the entity, including changes thereto, based on the auditor's understanding of the entity and the audit evidence obtained during the audit. The evaluation also may include consideration, for example, of the disclosures needed to achieve a fair presentation arising from matters that could be material, such as the effect of evolving financial reporting requirements or the changing economic environment. In general, misstatements are considered material if they could reasonably be expected to influence the economic decisions of the users taken on the basis of the financial statements as a whole.<sup>16</sup>

**.A15** Evaluating whether the financial statements achieve fair presentation may include, for example, discussions with management and those charged with governance about their views on why a particular presentation was chosen, as well as alternatives that may have been considered. The discussions may include, for example, the following:

- The degree to which the amounts in the financial statements are aggregated or disaggregated, and whether the presentation of amounts or disclosures obscures useful information or results in misleading information
- Consistency with appropriate industry practice, or whether any departures are relevant to the entity's circumstances and therefore warranted

**.A16** The auditor's professional judgment concerning the fairness of the presentation of the financial statements is applied within the context of the financial reporting framework. Without that framework, the auditor would have no consistent standard for evaluating the presentation of financial position, results of operations, and cash flows in financial statements.

***Description of the Applicable Financial Reporting Framework (Ref: par. .17)***

**.A17** As explained in AU-C section 200, the preparation and fair presentation of the financial statements by management and, when appropriate, those charged with governance requires the inclusion of an adequate description of the applicable financial reporting framework in the financial statements.<sup>17</sup> That description is important because it advises users of the financial statements of the framework on which the financial statements are based.

**.A18** The description may indicate that the financial statements have been prepared in accordance with that framework. Such a statement is appropriate only when the financial

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<sup>15</sup> Paragraph .14 of AU-C section 200.

<sup>16</sup> See AU-C section 320.

<sup>17</sup> Paragraphs .A2–.A3 of AU-C section 200.

statements comply with all the requirements of that framework that are effective during the period covered by the financial statements.

**.A19** Financial statements that are prepared in accordance with one financial reporting framework and that contain a note or supplementary statement reconciling the results to those that would be shown under another framework are not prepared in accordance with that other framework. This is because the financial statements do not include all the information in the manner required by that other framework.

**.A20** The financial statements may, however, be prepared in accordance with one applicable financial reporting framework and, in addition, describe in the notes to the financial statements the extent to which the financial statements comply with another framework. Such information may not be required by the applicable financial reporting framework but may be presented as part of the basic financial statements. As discussed in paragraph .60, such information is considered an integral part of the financial statements if it cannot be clearly differentiated and, accordingly, is covered by the auditor's opinion.

#### **Form of Opinion (Ref. par. .20)**

**.A21** In some instances, the financial statements, although prepared in accordance with the requirements of a fair presentation framework, do not achieve fair presentation. When this is the case, it may be possible for management to include additional disclosures in the financial statements beyond those specifically required by the framework or, in unusual circumstances, to depart from a requirement in the framework in order to achieve fair presentation of the financial statements, which would be extremely rare.

**.A22** The "Accounting Principles Rule" (ET sec. 1.320.001)<sup>‡</sup> of the AICPA Code of Professional Conduct states the following:

A member shall not (1) express an opinion or state affirmatively that the financial statements or other financial data of any entity are presented in conformity with generally accepted accounting principles or (2) state that he or she is not aware of any material modifications that should be made to such statements or data in order for them to be in conformity with generally accepted accounting principles, if such statements or data contain any departure from an accounting principle promulgated by bodies designated by Council to establish such principles that has a material effect on the statements or data taken as a whole. If, however, the statements or data contain such a departure and the member can demonstrate that due to unusual circumstances the financial statements or data would otherwise have been misleading, the member can comply with the rule by describing the departure, its approximate effects, if practicable, and the reasons why compliance with the principle would result in a misleading statement.

#### **Auditor's Report (Ref. par. .21)**

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<sup>‡</sup> All ET sections can be found in AICPA *Professional Standards*.

**.A23** A written report encompasses reports issued in hard copy format and those using an electronic medium.

**.A24** The exhibit “Illustrations of Auditor’s Reports on Financial Statements” contains illustrations of auditor’s reports on financial statements incorporating the elements required by paragraphs .22–.42. With the exception of the “Opinion” and “Basis for Opinion” sections, this section does not establish requirements for ordering the elements of the auditor’s report. However, this section requires the use of specific headings, which are intended to assist in making auditor’s reports that refer to audits that have been conducted in accordance with GAAS more recognizable, particularly in situations in which the elements of the auditor’s report are presented in an order that differs from the illustrative auditor’s reports in the exhibit to this section.

### ***Auditor’s Report for Audits Conducted in Accordance With GAAS***

*Title (Ref: par. .22)*

**.A25** AU-C section 200 provides guidance on reporting when the auditor is not independent.<sup>18</sup>

*Addressee (Ref: par. .23)*

**.A26** The auditor’s report is normally addressed to those for whom the report is prepared. The report may be addressed to the entity whose financial statements are being audited or to those charged with governance. A report on the financial statements of an unincorporated entity may be addressed as circumstances dictate (for example, to the partners, general partner, or proprietor). Occasionally, an auditor may be retained to audit the financial statements of an entity that is not a client; in such a case, the report may be addressed to the client and not to those charged with governance of the entity whose financial statements are being audited.

*Auditor’s Opinion (Ref: par. .25–.27)*

**.A27** The auditor’s report states, for example, that the auditor has “audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders’ equity, and cash flows for the year then ended, and the related notes to the financial statements.” If the financial statements include a separate statement of changes in stockholders’ equity accounts or a separate statement of comprehensive income, paragraph .25c requires such statements to be identified in the “Opinion” section, but they need not be referred to separately in the opinion paragraph because changes in stockholders’ equity accounts and comprehensive income are considered part of the presentation of financial position, results of operations, and cash flows.

**.A28** The identification of the title and the dates of, or periods covered by, each statement that the financial statements comprise may also be achieved by referencing the table of contents in a document bound with or accompanying the financial statements and auditor’s report thereon.

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<sup>18</sup> Paragraph .A18 of AU-C section 200.

**.A29** When the auditor is aware that the audited financial statements will be included in a document that contains information in addition to the financial statements and the auditor's report thereon, the auditor may consider, if the form of presentation allows, identifying the page numbers on which the audited financial statements are presented. This helps users identify the financial statements to which the auditor's report relates.

**.A30** When the auditor expresses an unmodified opinion, it is not appropriate to use phrases such as "with the foregoing explanation" or "subject to" in relation to the opinion because these suggest a conditional opinion or a weakening or modification of the opinion.

**.A31** The auditor's opinion covers the complete set of financial statements, as defined by the applicable financial reporting framework. For example, in the case of many general purpose frameworks, the financial statements include a balance sheet, an income statement, a statement of changes in equity, and a cash flow statement, including related notes. In some circumstances, additional or different statements, schedules, or information also might be considered an integral part of the financial statements.

**.A32** The reports in the exhibit "Illustrations of Auditor's Reports on Financial Statements" include example wording that may be used to replace the [...] based on the applicable financial reporting framework.

**.A33** The title of the financial statements identified in the "Opinion" section (see paragraph .25c) describes the information that is the subject of the auditor's opinion.

**.A34** *Description of the applicable financial reporting framework and how it may affect the auditor's opinion (Ref: par. .27).* The identification of the applicable financial reporting framework in the auditor's opinion is intended to advise users of the auditor's report of the context in which the auditor's opinion is expressed; it is not intended to limit the evaluation required in paragraph .16. For example, the applicable financial reporting framework may be identified as accounting principles generally accepted in the United States of America or U.S. generally accepted accounting principles or International Financial Reporting Standards promulgated by the International Accounting Standards Board (IASB) or *International Financial Reporting Standard for Small- and Medium-Sized Entities* promulgated by the IASB.

*Basis for Opinion (Ref: par. .28)*

**.A35** The "Basis for Opinion" section provides important context about the auditor's opinion. Accordingly, this section requires the "Basis for Opinion" section to directly follow the "Opinion" section in the auditor's report.

**.A36** The reference to the standards used conveys to the users of the auditor's report that the audit has been conducted in accordance with established standards. For example, the auditor's report may refer to auditing standards generally accepted in the United States of America or U.S. generally accepted auditing standards.

**.A37** In accordance with AU-C section 200, the auditor does not represent compliance with GAAS in the auditor’s report unless the auditor has complied with the requirements of AU-C section 200 and all other AU-C sections relevant to the audit.<sup>19</sup>

Relevant Ethical Requirements (Ref: par. .28c)

**.A38** AU-C section 200 explains that ethical requirements consist of the AICPA Code of Professional Conduct together with rules of state boards of accountancy and applicable regulatory agencies that are more restrictive.<sup>20</sup> When the AICPA Code of Professional Conduct applies, the auditor’s other ethical responsibilities relate to the principles of professional conduct (ET sec. 0.300, “Principles of Professional Conduct”).

**.A39** Relevant ethical requirements may exist in several different sources, such as ethical codes and additional rules and requirements within law and regulation. When independence and other relevant ethical requirements are contained in a limited number of sources, the auditor may choose to name the relevant sources (for example, the AICPA Code of Professional Conduct, when applicable; the rule or applicable regulation; or *Government Auditing Standards* promulgated by the Comptroller General of the United States) or may refer to a term that appropriately describes those sources. Relevant ethical requirements, including those pertaining to independence, in a group audit situation may be complex. AU-C section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*,<sup>21</sup> provides guidance for auditors in performing work on the financial information of a component for a group audit, including those situations in which the component auditor does not meet the independence requirements that are relevant to the group audit.

Key Audit Matters (Ref. par. .30)

**.A40** AU-C section 210, *Terms of Engagement*, requires the audit engagement letter or other suitable form of written agreement to include reference to the expected form and content of any reports to be issued by the auditor.<sup>22</sup>

*Responsibilities of Management for the Financial Statements (Ref: par. .31–.33)*

**.A41** AU-C section 200 explains the premise relating to the responsibilities of management and, when appropriate, those charged with governance on which an audit in accordance with GAAS is conducted.<sup>23</sup> Management and, when appropriate, those charged with governance accept responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including their fair presentation. Management also accepts responsibility for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. The description of management’s responsibilities in the auditor’s

<sup>19</sup> Paragraph .22 of AU-C section 200.

<sup>20</sup> Paragraph .A15 of AU-C section 200.

<sup>21</sup> Paragraphs .22–.23 of AU-C section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*.

<sup>22</sup> Paragraph .10 of AU-C section 210, *Terms of Engagement*.

<sup>23</sup> Paragraphs .05 and .A2 of AU-C section 200.

report includes reference to both of these responsibilities because it helps explain to users the premise on which an audit is conducted. AU-C section 260 uses the term *those charged with governance* to describe the persons or organizations with responsibility for overseeing the entity, and provides a discussion about the diversity of governance structures among entities.

**.A42** In some instances, a document containing the auditor's report may include a separate statement by management or those charged with governance regarding their responsibility for the preparation of the financial statements. Any elaboration in the auditor's report about the responsibilities of management or those charged with governance regarding the preparation of the financial statements, or reference to a separate statement by management or those charged with governance about such responsibilities if one is included in a document containing the auditor's report, may lead users to erroneously believe that the auditor is providing assurances about representations made by management or those charged with governance about their responsibility for financial reporting, internal control, and other matters that might be discussed in the management report.

*Auditor's Responsibilities for the Audit of the Financial Statements (Ref. par. .34–.37)*

**.A43** The description of the auditor's responsibilities as required by paragraphs .34–.37 of this section may be tailored to reflect the specific nature of the entity, for example, when the auditor's report addresses consolidated financial statements.

*Objectives of the Auditor (Ref. par. .35a–c)*

**.A44** The auditor's report explains that the objectives of the auditor are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes the auditor's opinion. These objectives are in contrast to management's responsibilities for the preparation and fair presentation of the financial statements.

**.A45** Because the auditor's opinion is based on obtaining reasonable assurance, the auditor's report does not constitute a guarantee. Because of the inherent limitation of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with GAAS. Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with GAAS.<sup>24</sup>

**.A46** When the applicable financial reporting framework defines materiality differently from the definition in AU-C section 320, *Materiality in Planning and Performing an Audit*, the auditor's report may need to reflect the definition or description of materiality from the applicable financial reporting framework.

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<sup>24</sup> Paragraph .A56 of AU-C section 200 and paragraph .10d of AU-C section 210.

*Other Reporting Responsibilities (Ref. par. .38–.39)*

**.A47** In some circumstances, the auditor may have additional responsibilities to report on other matters that are supplementary to the auditor’s responsibility under GAAS to report on the financial statements. The form and content of the “Other Reporting Responsibilities” section of the auditor’s report described in paragraph .38 will vary depending on the nature of the auditor’s other reporting responsibilities. For example, for audits conducted under *Government Auditing Standards*, the auditor may be required to report on internal control over financial reporting and compliance with laws, regulations, and provisions of contracts or grant agreements, which may be included in the “Other Reporting Responsibilities” section of the auditor’s report.<sup>25</sup> However, when the auditor is engaged or required by law or regulation to perform a compliance audit in accordance with GAAS, *Government Auditing Standards*, and a governmental audit requirement, reporting requirements in AU-C section 935, *Compliance Audits*, apply.

**.A48** In some cases, the relevant law or regulation may require or permit the auditor to report on these other responsibilities within the auditor’s report on the financial statements. In other cases, the auditor may be required or permitted to report on them in a separate report.

**.A49** These other reporting responsibilities are addressed in a separate section of the auditor’s report in order to clearly distinguish them from the auditor’s responsibility under GAAS to report on the financial statements. When relevant, this section of the auditor’s report may contain subheadings that describe the content of the other reporting responsibility paragraphs.

*Signature of the Auditor (Ref. par. .40)*

**.A50** In some cases, law or regulation may allow for the use of electronic signatures in the auditor’s report.

**.A51** In certain situations, the auditor’s report may be required by law or regulation to include the personal name and signature of the auditor, in addition to the auditor’s firm.

**.A52** *Considerations specific to governmental entities.* This section would not preclude a governmental auditor from including the personal name and signature of the auditor in the auditor’s report when, in certain situations, the governmental auditor is required by law or regulation or chooses to do so.

*Auditor’s Address (Ref. par. .41)*

**.A53** In the United States, the location of the issuing office is the city and state. In another country, it may be the city and country.

*Date of the Auditor’s Report (Ref. par. .42)*

**.A54** AU-C section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, requires that, on or before the date of the auditor’s report,

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<sup>25</sup> See AICPA Audit and Accounting Guide *Government Auditing Standards and Single Audits* for illustrative auditor reports.

the engagement partner, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued.<sup>26</sup> When an engagement quality control review is performed, AU-C section 220 requires that the auditor's report not be released prior to the completion of the engagement quality control review.<sup>27</sup>

**.A55** The date of the auditor's report informs the user of the auditor's report that the auditor has considered the effect of events and transactions of which the auditor became aware and that occurred up to that date. The auditor's responsibility for events and transactions after the date of the auditor's report is addressed in AU-C section 560.

**.A56** Because the auditor's opinion is provided on the financial statements, and the financial statements are the responsibility of management, the auditor is not in a position to conclude that sufficient appropriate audit evidence has been obtained until evidence is obtained that all the statements and disclosures that the financial statements comprise have been prepared, and management has accepted responsibility for them.

#### *Considerations Specific to Governmental Entities*

**.A57** In some circumstances, final approval of the financial statements by governmental legislative bodies (or subsets of such legislative bodies) is required before the financial statements are issued. In these circumstances, final approval by such legislative bodies (or subsets of such legislative bodies) is not necessary for the auditor to conclude that sufficient appropriate audit evidence has been obtained. The date of approval of the financial statements, for purposes of GAAS, is the earlier date on which those with the recognized authority determine that all the statements and disclosures that the financial statements comprise have been prepared and that those with the recognized authority have asserted that they have taken responsibility for them.

#### ***Auditor's Report for Audits Conducted in Accordance With Both GAAS and Another Set of Auditing Standards (Ref. par. .43)***

**.A58** If the audit is performed in accordance with both GAAS and the ISAs, the auditor may find it helpful to refer to AU-C appendix B, "Substantive Differences Between the International Standards on Auditing and Generally Accepted Auditing Standards." This appendix summarizes substantive differences between the ISAs and GAAS to assist the auditor in planning and performing an engagement in accordance with the ISAs.

#### ***Auditor's Report for Audits Conducted in Accordance With the Standards of the PCAOB and GAAS When the Audit Is Not Within the Jurisdiction of the PCAOB (Ref. par. .45)***

**.A59** Auditors of financial statements of entities whose audits are within the jurisdiction of the PCAOB, which include issuers (as defined by the SEC) and nonissuer brokers and dealers registered with the SEC, are required to be registered with, and subject to inspection by, the

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<sup>26</sup> See paragraph .19 of AU-C section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, for further discussion.

<sup>27</sup> Paragraph .21 of AU-C section 220.

PCAOB. In such circumstances, the AICPA Code of Professional Conduct requires AICPA members to conduct the audit in accordance with the standards of the PCAOB, and the audit is not required to also be conducted in accordance with GAAS.<sup>28</sup>

**.A60** As discussed in paragraph .45, because the auditor is required to also conduct the audit in accordance with GAAS, it would be inappropriate for the auditor to issue a report that refers only to the standards of the PCAOB without also referring to GAAS.

**.A61** When the auditor follows the standards of the PCAOB regarding the form of the auditor's report, PCAOB reporting requirements for specific circumstances, such as reporting on an integrated audit or supplementary information, may also be applicable.

**.A62** The form of the auditor's report required by the standards of the PCAOB states that the audit was conducted in accordance with "the standards of the Public Company Accounting Oversight Board (United States)." A reference to "the standards" of the PCAOB indicates that the auditor has complied not only with the PCAOB's auditing standards but also with the related professional practice standards of the PCAOB, including its independence rules; whereas a reference to "the auditing standards of the Public Company Accounting Oversight Board (United States)" indicates compliance with only the auditing standards of the PCAOB. The auditor of financial statements of an entity whose audits are not within the jurisdiction of the PCAOB may, nevertheless, be responsible for complying with the independence and other related professional practice standards of the PCAOB if, for example, the engagement is subject to regulatory oversight that requires compliance with those rules. Whether the auditor conducts an audit of financial statements in accordance with the standards of the PCAOB or the auditing standards of the PCAOB depends on the circumstances of the engagement.<sup>29</sup>

**.A63** Examples of situations in which an auditor may be engaged to conduct an audit in accordance with the standards (or auditing standards) of the PCAOB for an entity whose audit is not within the jurisdiction of the PCAOB include audits for clearing agencies and futures commission merchants registered with the U.S. Commodities Futures Trading Commission (CFTC), as well as other entities registered with the CFTC; audits of financial statements included in certain securities offering documents pursuant to Regulation A of the Securities Act of 1933; and circumstances in which a nonissuer company desires, or is required by contractual agreement, to obtain an audit of its financial statements in accordance with the standards of the PCAOB.

**.A64** When an audit is being conducted in accordance with the standards of the PCAOB, the auditor would follow the relevant requirements in the PCAOB standards regarding the determination and reporting of critical audit matters. This would not affect the requirement for the auditor to state in the auditor's report that the audit was also conducted in accordance with GAAS, as required by paragraph .45 of this section.

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<sup>28</sup> See the "Compliance With Standards Rule" (ET sec. 1.310.001) and appendix A, "Council Resolution Designating Bodies to Promulgate Technical Standards," of the AICPA Code of Professional Conduct.

<sup>29</sup> See Staff Question and Answer, *Audits of Financial Statements of Non-Issuers Performed Pursuant to the Standards of the Public Company Accounting Oversight Board* (PCAOB Staff Guidance, sec. 100.01), dated June 30, 2004, in *AICPA PCAOB Standards and Related Rules*.

**.A65** The exhibit “Illustrations of Auditor’s Reports on Financial Statements” contains an example of an auditor’s report for the situation described in paragraph .45.

### **Comparative Financial Statements and Comparative Information (Ref. par. .46–.47)**

**.A66** The level of information included for the prior periods in comparative financial statements is comparable with that of the financial statements of the current period.

**.A67** Because the auditor’s report on comparative financial statements applies to the financial statements for each of the periods presented, the auditor may express a qualified opinion or an adverse opinion, disclaim an opinion, or include an emphasis-of-matter paragraph with respect to one or more financial statements for one or more periods while expressing a different auditor’s opinion on one or more financial statements of another period presented.

### ***Updating the Report***

**.A68** An updated report on prior period financial statements is distinguished from a reissuance of a previous report.<sup>30</sup> When issuing an updated report, the information considered by the continuing auditor is that which the auditor has become aware of during the audit of the current period financial statements. In addition, an updated report is issued in conjunction with the auditor’s report on the current period financial statements.

### ***Other Considerations Relating to Comparative Financial Statements***

**.A69** If one firm of independent auditors merges with another firm, and the new firm becomes the auditor of a former client of one of the two former firms, the new firm may accept responsibility and express an opinion on the financial statements for the prior periods, as well as on those for the current period. In such circumstances, paragraphs .46–.59 apply. The new firm may indicate in the auditor’s report or as part of the signature that a merger took place and may name the firm of independent auditors that was merged with it. If the new firm decides not to express an opinion on the prior period financial statements, the guidance for the reissuance of reports in AU-C section 560 would apply.

### ***Comparative Information (Ref: par. .48–.49)***

**.A70** Comparative information, which may be condensed financial statements or prior period summarized financial information, is not considered comparative financial statements because it is not a complete set of financial statements. For example, entities such as state and local governmental units frequently present total-all-funds information for the prior periods rather than information by individual funds because of space limitations or to avoid cumbersome or confusing formats. Also, not-for-profit organizations frequently present certain summarized financial information for the prior periods in total rather than by net asset class. Accordingly, the auditor need not opine on comparative information in accordance with this section.

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<sup>30</sup> See AU-C section 560, *Subsequent Events and Subsequently Discovered Facts*.

**.A71** Paragraph .48 requires the auditor to clearly indicate the character of the auditor's work, if any, and the degree of responsibility the auditor is taking in the auditor's report when comparative information is presented but not covered by the auditor's opinion on the financial statements of the current period. The requirements and guidance in AU-C section 930, *Interim Financial Information*, may be adapted to report on condensed financial statements or prior period summarized financial information that is derived from audited financial statements and is presented comparatively with the complete set of financial statements of the current period.<sup>31, 32</sup> The exhibit to this section provides examples of auditor's reports when comparative summarized financial information for the prior period is presented.<sup>33</sup>

**.A72** If an entity requests the auditor to express an opinion on all periods presented, and comparative information is presented for one or more prior periods, in most cases, this will necessitate including additional columns or separate detail by fund or net asset class, or the auditor may need to modify the auditor's opinion, as required by section 705 of this SAS.

***Written Representations (Ref: par. .54)***

**.A73** In the case of comparative financial statements, the written representations are requested for all periods referred to in the auditor's opinion because management needs to reaffirm that the written representations it previously made with respect to the prior period remain appropriate.

***Opinion on Prior Period Financial Statements Different From Previous Opinion (Ref: par. .55)***

**.A74** When reporting on the prior period financial statements in connection with the current period's audit, the opinion expressed on the prior period financial statements may be different from the opinion previously expressed if, during the course of the audit of the current period, the auditor becomes aware of circumstances or events that materially affect the financial statements of a prior period. In some circumstances, the auditor may have additional reporting responsibilities designed to prevent future reliance on the auditor's previously issued report on the prior period financial statements.<sup>34</sup>

***Prior Period Financial Statements Audited by a Predecessor Auditor (Ref: par. .57)***

**.A75** The predecessor auditor may be unable or unwilling to reissue the auditor's report on the prior period financial statements that have been restated. In this situation, provided that the auditor has audited the adjustments to the prior period financial statements, the auditor may include an other-matter paragraph<sup>35</sup> in the auditor's report indicating that the predecessor auditor reported on the financial statements of the prior period before restatement. In addition, if the auditor is engaged

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<sup>31</sup> Paragraph .33 of AU-C section 930, *Interim Financial Information*.

<sup>32</sup> See the AICPA Audit and Accounting Guides *State and Local Governments* and *Not-for-Profit Entities* for further guidance on reporting on summarized comparative financial information.

<sup>33</sup> Illustration 5, "An Auditor's Report on Financial Statements for a Single Year Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When Comparative Summarized Financial Information Derived From Audited Financial Statements for the Prior Year is Presented," of the exhibit "Illustrations of Auditor's Reports on Financial Statements."

<sup>34</sup> See AU-C section 560.

<sup>35</sup> See section 706 of this SAS.

to audit the adjustments and obtains sufficient appropriate audit evidence to be satisfied about the appropriateness of the restatement, the auditor's report may also include the following within the other-matter paragraph:

As part of our audit of the 20X2 financial statements, we also audited the adjustments described in Note X that were applied to restate the 20X1 financial statements. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the 20X1 financial statements of the Company other than with respect to the adjustments, and, accordingly, we do not express an opinion or any other form of assurance on the 20X1 financial statements as a whole.

***Prior Period Financial Statements Not Audited (Ref: par. .58–.59)***

**.A76** The following is an example of an other-matter paragraph when a review was performed on the prior period financial statements:

*Other Matter*

The 20X1 financial statements were reviewed by us (other accountants) and our (their) report thereon, dated March 1, 20X2, stated we (they) were not aware of any material modifications that should be made to those statements for them to be in accordance with accounting principles generally accepted in the United States of America. A review is substantially less in scope than an audit and does not provide a basis for the expression of an opinion on the financial statements as a whole.

**.A77** The following is an example of an other-matter paragraph when a compilation was performed on the prior period financial statements:

*Other Matter*

We (other accountants) performed a compilation engagement with respect to the 20X1 financial statements and our (their) report thereon, dated March 1, 20X2, stated we (they) did not audit or review those financial statements and, accordingly, express no opinion or other form of assurance on them.

**.A78** If the prior period financial statements were not audited, reviewed, or compiled, the following is an example of an other-matter paragraph:

*Other Matter*

The accompanying balance sheet of X Company as of December 31, 20X1, and the related statements of income and cash flows for the year then ended were not audited, reviewed, or compiled by us, and, accordingly, we do not express an opinion or any other form of assurance on them.

**Information Presented in the Financial Statements (Ref. par. .60)**

*Forming an Opinion and Reporting on Financial Statements*

**.A79** In some circumstances, the entity may be required by law, regulation, or standards, or may voluntarily choose, to include in the basic financial statements information that is not required by the applicable financial reporting framework. The auditor's opinion covers information that cannot be clearly differentiated from the financial statements because of its nature and how it is presented.

**.A80** If the information included in the basic financial statements is not required by the applicable financial reporting framework and is not necessary for fair presentation but is clearly differentiated, then such information may be identified as "unaudited" or as "not covered by the auditor's report."

**.A81**

**Exhibit — Illustrations of Auditor’s Reports on Financial Statements (Ref: par. .A24, .A32, .A65, and .A71)**

Illustration 1: An Auditor’s Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Illustration 2: An Auditor’s Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America, Including Communication of Key Audit Matters

Illustration 3: An Auditor’s Report on Financial Statements for a Single Year Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Illustration 4: An Auditor’s Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Audit Has Been Conducted in Accordance With Both Auditing Standards Generally Accepted in the United States of America and International Standards on Auditing

Illustration 5: An Auditor’s Report on Financial Statements for a Single Year Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When Comparative Summarized Financial Information Derived From Audited Financial Statements for the Prior Year Is Presented

Illustration 6: An Auditor’s Report on Financial Statements for a Single Year Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When Comparative Summarized Financial Information Derived From Unaudited Financial Statements for the Prior Year Is Presented

Illustration 7: An Auditor’s Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Audit Has Been Conducted by a Registered Firm in Accordance With Both Auditing Standards Generally Accepted in the United States of America and the Auditing and Professional Practice Standards of the Public Company Accounting Oversight Board

Illustration 8: An Auditor’s Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Audit Has Been Conducted by a Nonregistered Firm in Accordance With Both Auditing Standards Generally Accepted in the United States of America and the Auditing Standards of the Public Company Accounting Oversight Board

**Illustration 1: An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America**

Circumstances include the following:

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

## **Independent Auditor's Report**

[Appropriate Addressee]

### **Report on the Audit of the Financial Statements<sup>1</sup>**

#### ***Opinion***

We have audited the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X1 and 20X0, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

#### ***Basis for Opinion***

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

#### ***Responsibilities of Management for the Financial Statements***

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

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

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<sup>1</sup> The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

***Auditor's Responsibilities for the Audit of the Financial Statements***

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

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>2</sup>
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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<sup>2</sup> In circumstances in which the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

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

**Report on Other Legal and Regulatory Requirements**

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

*[Signature of the auditor’s firm]*

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

*[Date of the auditor’s report]*

**Illustration 2: An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America, Including Communication of Key Audit Matters**

Circumstances include the following:

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

## **Independent Auditor's Report**

[Appropriate Addressee]

### **Report on the Audit of the Financial Statements<sup>1</sup>**

#### ***Opinion***

We have audited the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X1 and 20X0, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

#### ***Basis for Opinion***

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

#### ***Key Audit Matters***

Key audit matters are those matters that were communicated with those charged with governance and, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

[Description of each key audit matter in accordance with section 701, Communicating Key Audit Matters in the Independent Auditor's Report, of this SAS]

#### ***Responsibilities of Management for the Financial Statements***

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<sup>1</sup> The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

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

### ***Auditor's Responsibilities for the Audit of the Financial Statements***

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

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>2</sup>

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<sup>2</sup> In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

### **Report on Other Legal and Regulatory Requirements**

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

*[Signature of the auditor's firm]*

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

*[Date of the auditor's report]*

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expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

**Illustration 3: An Auditor's Report on Financial Statements for a Single Year Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America**

Circumstances include the following:

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

**Independent Auditor's Report**

[Appropriate Addressee]

**Report on the Audit of the Financial Statements<sup>1</sup>**

***Opinion***

We have audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

***Basis for Opinion***

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

***Responsibilities of Management for the Financial Statements***

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

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

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<sup>1</sup> The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

***Auditor's Responsibilities for the Audit of the Financial Statements***

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

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>2</sup>
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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<sup>2</sup> In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

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

**Report on Other Legal and Regulatory Requirements**

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

*[Signature of the auditor’s firm]*

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

*[Date of the auditor’s report]*

**Illustration 4: An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Audit Has Been Conducted in Accordance With Both Auditing Standards Generally Accepted in the United States of America and International Standards on Auditing**

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). The audit is a group audit. The auditor is not making reference to a component auditor in the auditor's report.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The financial statements are audited in accordance with auditing standards generally accepted in the United States of America and International Standards on Auditing (ISAs).<sup>1</sup>
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in AU-C section 210, *Terms of Engagement*, and ISA 210, *Agreeing the Terms of Audit Engagements*.
- The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit comprise relevant ethical requirements in the United States of America and the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.

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<sup>1</sup> Paragraph 50 of International Standard on Auditing (ISA) 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, allows the auditor to use the layout or wording of the national auditing standards (in this case, GAAS), provided that (1) there are no conflicts between the requirements in GAAS and the ISAs that would lead to a different conclusion with respect to the opinion, and (2) the layout or wording addresses, and is not inconsistent with, certain of the required minimum reporting elements in ISA 700 (Revised).

- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- The auditor has not been engaged to communicate key audit matters.

### **Independent Auditor's Report**

*[Appropriate Addressee]*

#### **Report on the Audit of the Financial Statements<sup>2</sup>**

##### ***Opinion***

We have audited the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X1 and 20X0, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

##### ***Basis for Opinion***

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS) and in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of ABC Company, and have fulfilled our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits, which include relevant ethical requirements in the United States of America and the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants*. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

##### ***Responsibilities of Management and Those Charged With Governance for the Financial Statements***

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for

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<sup>2</sup> The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*]; to disclose, as applicable, matters related to going concern; and to use the going concern basis of accounting unless management either intends to liquidate ABC Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing ABC Company's financial reporting process.

### ***Auditor's Responsibilities for the Audit of the Financial Statements***

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

In performing an audit in accordance with GAAS and ISAs, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing

an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>3</sup>

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the ABC Company to express an opinion on the financial statements. We are responsible for the direction, supervision, and performance of the group audit of ABC Company. We remain solely responsible for our audit opinion.<sup>4</sup>

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

### **Report on Other Legal and Regulatory Requirements**

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

*[Signature of the auditor's firm]*

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

*[Date of the auditor's report]*

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<sup>3</sup> In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

<sup>4</sup> This has been included to comply with paragraph 50(k) of ISA 700 (Revised).

**Illustration 5: An Auditor's Report on Financial Statements for a Single Year Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When Comparative Summarized Financial Information Derived From Audited Financial Statements for the Prior Year Is Presented**

Circumstances include the following:

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

**Independent Auditor's Report**

[Appropriate Addressee]

**Report on the Audit of the Financial Statements<sup>1</sup>**

***Opinion***

We have audited the financial statements of XYZ Not-for-Profit Organization, which comprise the statement of financial position as of September 30, 20X1, and the related statements of activities and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of XYZ Not-for-Profit Organization as of September 30, 20X1, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

***Basis for Opinion***

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of XYZ Not-for-Profit Organization and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

***Responsibilities of Management for the Financial Statements***

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about XYZ Not-for-

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<sup>1</sup> The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

Profit Organization's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

### ***Auditor's Responsibilities for the Audit of the Financial Statements***

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

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of XYZ Not-for-Profit Organization's internal control. Accordingly, no such opinion is expressed.<sup>2</sup>
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

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<sup>2</sup> In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of XYZ Not-for-Profit Organization's internal control. Accordingly, no such opinion is expressed."

- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about XYZ Not-for-Profit Organization's ability to continue as a going concern for a reasonable period of time.

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

### ***Report on Summarized Comparative Information***

We have previously audited XYZ Not-for-Profit Organization's 20X0 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated December 15, 20X0. In our opinion, the summarized comparative information presented herein as of and for the year ended September 30, 20X0, is consistent, in all material respects, with the audited financial statements from which it has been derived.

### **Report on Other Legal and Regulatory Requirements**

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

*[Signature of the auditor's firm]*

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

*[Date of the auditor's report]*

**Illustration 6: An Auditor's Report on Financial Statements for a Single Year Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When Comparative Summarized Financial Information Derived From Unaudited Financial Statements for the Prior Year Is Presented**

Circumstances include the following:

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

**Independent Auditor's Report**

[Appropriate Addressee]

**Report on the Audit of the Financial Statements<sup>1</sup>**

***Opinion***

We have audited the financial statements of XYZ Not-for-Profit Organization, which comprise the statement of financial position as of September 30, 20X1, and the related statements of activities and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of XYZ Not-for-Profit Organization as of September 30, 20X1, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

***Basis for Opinion***

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of XYZ Not-for-Profit Organization and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

***Responsibilities of Management for the Financial Statements***

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about XYZ Not-for-

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<sup>1</sup> The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

Profit Organization's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

### ***Auditor's Responsibilities for the Audit of the Financial Statements***

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

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of XYZ Not-for-Profit Organization's internal control. Accordingly, no such opinion is expressed.<sup>2</sup>
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

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<sup>2</sup> In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of XYZ Not-for-Profit Organization's internal control. Accordingly, no such opinion is expressed."

- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about XYZ Not-for-Profit Organization's ability to continue as a going concern for a reasonable period of time.

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

***Report on Summarized Comparative Information***

The summarized comparative information presented herein as of and for the year ended September 30, 20X0, derived from those unaudited financial statements, has not been audited, reviewed, or compiled, and, accordingly, we express no opinion on it.

**Report on Other Legal and Regulatory Requirements**

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

*[Signature of the auditor's firm]*

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

*[Date of the auditor's report]*

**Illustration 7: An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Audit Has Been Conducted by a Registered Firm in Accordance With Both Auditing Standards Generally Accepted in the United States of America and the Auditing and Professional Practice Standards of the Public Company Accounting Oversight Board**

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative) of an entity whose audit is not within the jurisdiction of the PCAOB as defined by the Sarbanes-Oxley Act of 2002, as amended. The audit is not a group audit.
- The firm is registered with the PCAOB and for purposes of this engagement is required by regulation to be in compliance with the independence standards and other professional practice standards of the PCAOB and SEC.
- Management is not required to report on the entity's internal control over financial reporting.
- The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America.

**Report of Independent Registered Public Accounting Firm**

[To the Shareholders and the Board of Directors of X Company]<sup>1</sup>

**Opinion on the Financial Statements**

We have audited the accompanying balance sheets of X Company (the Company) as of December 31, 20X2 and 20X1, the related statements of income, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 20X2, and the related notes [and schedules] (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of [at] December 31, 20X2 and 20X1, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 20X2, in conformity with accounting principles generally accepted in the United States of America.

**Basis for Opinion**

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB and in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements,

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<sup>1</sup> See paragraph .07 of PCAOB Auditing Standard (AS) 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, in AICPA PCAOB Standards and Related Rules. Staff Guidance *Changes to the Auditor's Report Effective for Audits of Fiscal Years Ending on or After December 15, 2017* (PCAOB Staff Guidance sec. 300.04), states that

AS 3101 requires the auditor's report to be addressed to the shareholders and the board of directors, or equivalents for companies not organized as corporations. For example, if a company is not organized as a corporation, the auditor's report would generally be addressed to (1) the plan administrator and plan participants for a benefit plan; (2) the directors (or equivalent) and equity owners for a broker or dealer; and (3) the trustees and unit holders or other investors for an investment company organized as a trust. The auditor's report may include additional addressees. Since inclusion of additional addressees is voluntary, auditors can assess, based on the individual circumstances, whether to include additional addressees in the auditor's report.

whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.<sup>2</sup>

### **Critical Audit Matters (if Applicable)**

The critical audit matters communicated below are matters arising from the current period audit of the financial statements that were communicated or required to be communicated to the audit committee<sup>3</sup> and that: (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matters below,

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<sup>2</sup> As described in paragraphs .59–.60 of AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*, this section should be revised in situations in which management is required to report on the effectiveness of internal control over financial reporting but such report is not required to be audited, and the auditor has not been engaged to perform an audit of management’s assessment of the effectiveness of internal control over financial reporting. The following paragraphs should replace the second paragraph in the "Basis for Opinion" section in those circumstances. A similar paragraph may voluntarily be included in the auditor’s report in situations in which management is not required to report on internal control over financial reporting and neither is the auditor.

We conducted our audits in accordance with the standards of the PCAOB and in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits, we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

<sup>3</sup> AS 1301, *Communications with Audit Committees*, defines "audit committee" as

A committee (or equivalent body) established by and among the board of directors of a company for the purpose of overseeing the accounting and financial reporting processes of the company and audits of the financial statements of the company; if no such committee exists with respect to the company, the entire board of directors of the company.

For audits of nonissuers, if no such committee or board of directors (or equivalent body) exists with respect to the company, the person(s) who oversee the accounting and financial reporting processes of the company and audits of the financial statements of the company.

*Forming an Opinion and Reporting on Financial Statements*

providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

*[Include critical audit matters]*

*[Signature]*

We have served as the Company's auditor since [year].<sup>4</sup>

*[City and State or Country]*

*[Date]*

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<sup>4</sup> As discussed in Staff Guidance *Changes to the Auditor's Report Effective for Audits of Fiscal Years Ending on or After December 15, 2017*, AS 3101 does not specify a required location within the auditor's report for the statement on auditor tenure. The sample auditor's report includes the statement on auditor tenure at the end of the report; however, auditors have discretion to present auditor tenure in the part of the auditor's report they consider appropriate.

**Illustration 8: An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Audit Has Been Conducted by a Nonregistered Firm in Accordance With Both Auditing Standards Generally Accepted in the United States of America and the Auditing Standards of the Public Company Accounting Oversight Board**

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative) of an entity whose audit is not within the jurisdiction of the PCAOB as defined by the Sarbanes-Oxley Act of 2002, as amended.
- The firm is not registered with the PCAOB and for purposes of this engagement is not required to be in compliance with the independence standards and other professional practice standards of the PCAOB and SEC.
- Management is not required to report on the entity's internal control over financial reporting.
- The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America.

**Report of Independent Public Accounting Firm**

[To the Shareholders and the Board of Directors of X Company]<sup>1</sup>

**Opinion on the Financial Statements**

We have audited the accompanying balance sheets of X Company (the Company) as of December 31, 20X2 and 20X1, the related statements of income, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 20X2, and the related notes [and schedules] (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of [at] December 31, 20X2 and 20X1, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 20X2, in conformity with accounting principles generally accepted in the United States of America.

**Basis for Opinion**

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are required to be independent with respect to the Company in accordance with the relevant ethical requirements relating to our audits.

We conducted our audits in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States) and in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management,

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<sup>1</sup> See paragraph .07 of PCAOB Auditing Standard (AS) 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, in AICPA PCAOB Standards and Related Rules. Staff Guidance *Changes to the Auditor's Report Effective for Audits of Fiscal Years Ending on or After December 15, 2017* (PCAOB Staff Guidance sec. 300.04), states that

AS 3101 requires the auditor's report to be addressed to the shareholders and the board of directors, or equivalents for companies not organized as corporations. For example, if a company is not organized as a corporation, the auditor's report would generally be addressed to (1) the plan administrator and plan participants for a benefit plan, (2) the directors (or equivalent) and equity owners for a broker or dealer, and (3) the trustees and unit holders or other investors for an investment company organized as a trust. The auditor's report may include additional addressees. Since inclusion of additional addressees is voluntary, auditors can assess, based on the individual circumstances, whether to include additional addressees in the auditor's report.

as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.<sup>2</sup>

### **Critical Audit Matters (if applicable)**

The critical audit matters communicated below are matters arising from the current period audit of the financial statements that were communicated or required to be communicated to the audit committee<sup>3</sup> and that: (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

*[Include critical audit matters]*

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<sup>2</sup> As described in paragraphs .59–.60 of AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*, this section should be revised in situations in which management is required to report on the effectiveness of internal control over financial reporting but such report is not required to be audited, and the auditor has not been engaged to perform an audit of management's assessment of the effectiveness of internal control over financial reporting. The following paragraphs should replace the second paragraph in the "Basis for Opinion" section in those circumstances. A similar paragraph may voluntarily be included in the auditor's report in situations in which management is not required to report on internal control over financial reporting and neither is the auditor.

We conducted our audits in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States) and in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits, we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

<sup>3</sup> AS 1301, *Communications with Audit Committees*, defines "audit committee" as

A committee (or equivalent body) established by and among the board of directors of a company for the purpose of overseeing the accounting and financial reporting processes of the company and audits of the financial statements of the company; if no such committee exists with respect to the company, the entire board of directors of the company.

For audits of nonissuers, if no such committee or board of directors (or equivalent body) exists with respect to the company, the person(s) who oversee the accounting and financial reporting processes of the company and audits of the financial statements of the company

*Forming an Opinion and Reporting on Financial Statements*

[Signature]

We have served as the Company's auditor since [year].<sup>4</sup>

[City and State or Country]

[Date]

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<sup>4</sup> As discussed in Staff Guidance *Changes To The Auditor's Report Effective For Audits of Fiscal Years Ending On or After December 15, 2017*, AS 3101 does not specify a required location within the auditor's report for the statement on auditor tenure. The example auditor's report includes the statement on auditor tenure at the end of the report; however, auditors have discretion to present auditor tenure in the part of the auditor's report they consider appropriate.

.A82

**Appendix — Amendments to Various Sections in SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*, as Amended, and SAS No. 132, *The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern***

**Contents**

- [Section 200](#), Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards, *as amended* (AICPA, Professional Standards, AU-C sec. 200)
- [Section 210](#), Terms of Engagement (AICPA, Professional Standards, AU-C sec. 210)
- [Section 220](#), Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards, *as amended* (AICPA, Professional Standards, AU-C sec. 220)
- [Section 230](#), Audit Documentation, *as amended* (AICPA, Professional Standards, AU-C sec. 230)
- [Section 240](#), Consideration of Fraud in a Financial Statement Audit, *as amended* (AICPA, Professional Standards, AU-C sec. 240)
- [Section 260](#), The Auditor’s Communication With Those Charged With Governance, *as amended* (AICPA, Professional Standards, AU-C sec. 260)
- [Section 300](#), Planning an Audit, *as amended* (AICPA, Professional Standards, AU-C sec. 300)
- [Section 315](#), Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement, *as amended* (AICPA, Professional Standards, AU-C sec. 315)
- [Section 320](#), Materiality in Planning and Performing an Audit (AICPA, Professional Standards, AU-C sec. 320)
- [Section 330](#), Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained (AICPA, Professional Standards, AU-C sec. 330)
- [Section 450](#), Evaluation of Misstatements Identified During the Audit (AICPA, Professional Standards, AU-C sec. 450)

- [Section 510](#), **Opening Balances — Initial Audit Engagements, Including Reaudit Engagements (AICPA, Professional Standards, AU-C sec. 510)**
- [Section 540](#), **Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures (AICPA, Professional Standards, AU-C sec. 540)**
- [Section 600](#), **Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors), as amended (AICPA, Professional Standards, AU-C sec. 600)**
- [Section 910](#), **Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country (AICPA Professional Standards, AU-C sec. 910)**

*Amends SAS No. 132, The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern (AICPA, Professional Standards, [AU-C sec. 570](#))*

## **Amendments to Various Sections in SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*, as Amended**

*(Boldface italics denote new language. Deleted text is in ~~striketrough~~.)*

**The amendment to each AU-C section is effective for audits of financial statements for periods ending on or after December 15, 2020. Early implementation is not permitted.**

### ***AU-C Section 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards\****

[No amendments to paragraphs .01–.14.]

#### **Definitions**

**.14** For purposes of GAAS, the following terms have the meanings attributed as follows:

...

**Financial statements.** A structured representation of historical financial information, including ~~related notes~~ **disclosures**, intended to communicate an entity’s economic resources or obligations at a point in time, or the changes therein for a period of time, in accordance with a financial reporting framework. ~~The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information.~~ The term *financial statements* ordinarily refers to a complete set of

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

financial statements as determined by the requirements of the applicable financial reporting framework; but can also refer to a single financial statement. ***Disclosures comprise explanatory or descriptive information, set out as required, expressly permitted or otherwise allowed by the applicable financial reporting framework, on the face of a financial statement or in the notes, or incorporated therein by reference when expressly permitted.***

[No further amendments to AU-C section 200.]

### **AU-C Section 210, *Terms of Engagement***

[No amendments to paragraphs .01–.09.]

#### **Agreement on Audit Engagement Terms**

**.10** The agreed-upon terms of the audit engagement should be documented in an audit engagement letter or other suitable form of written agreement and should include the following: (Ref: par. .A22–.A26)

- a.* The objective and scope of the audit of the financial statements
- b.* The responsibilities of the auditor
- c.* The responsibilities of management
- d.* A statement that because of the inherent limitations of an audit, together with the inherent limitations of internal control, an unavoidable risk exists that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with GAAS
- e.* Identification of the applicable financial reporting framework for the preparation of the financial statements
- f.* Reference to the expected form and content of any reports to be issued by the auditor and a statement that circumstances may arise in which a report may differ from its expected form and content (***Ref. par. .A24***)

[No amendments to paragraphs .11–.A1.]

#### **Preconditions for an Audit**

[No amendments to paragraphs .A2–.A8.]

#### ***Agreement of the Responsibilities of Management*** (Ref: par. .06b)

**.A9** An audit in accordance with GAAS is conducted on the premise that management has acknowledged and understands that it has the responsibilities set out in paragraph .06b.<sup>5</sup>

The auditor may assist in preparing the financial statements, in whole or in part, based on information provided to the auditor by management during the performance of the audit.\* However, the concept of an independent audit requires that the auditor's role does not involve assuming management's responsibility for the preparation and fair presentation of the financial statements or assuming responsibility for the entity's related internal control and that the auditor has a reasonable expectation of obtaining the information necessary for the audit (*including information obtained from outside of the general and subsidiary ledgers*) insofar as management is able to provide or procure it. Accordingly, the premise is fundamental to the conduct of an independent audit. To avoid misunderstanding, agreement is reached with management that it acknowledges and understands that it has such responsibilities as part of agreeing and documenting the terms of the audit engagement in paragraphs .09–.10.

<sup>5</sup> [Footnote omitted for the purposes of this SAS.]

\*[Footnote omitted for the purposes of this SAS.]

[No amendments to paragraphs .A10–.A22.]

### **Audit Engagement Letter or Other Form of Written Agreement<sup>10</sup> (Ref. par. .10)**

#### *Form and Content of the Audit Engagement Letter*

**.A23** The form and content of the audit engagement letter may vary for each entity. Information included in the audit engagement letter on the auditor's responsibilities may be based on section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.<sup>11</sup> Paragraph .06b of this section addresses the description of the responsibilities of management. In addition to including the matters required by paragraph .10, an audit engagement letter may make reference to, for example, the following:

- Elaboration of the scope of the audit, including reference to applicable legislation, regulations, GAAS, and ethical and other pronouncements of professional bodies to which the auditor adheres
- *Arrangements regarding the planning and performance of the audit, including the composition of the engagement team*
- *The communication of key audit matters*
- The form of any other communication *about the* ~~of~~ results of the audit engagement

- ~~Arrangements regarding the planning and performance of the audit, including the composition of the audit team~~
- The expectation that management will provide written representations (see also paragraph .A11)
- *The expectation that management will provide access to all information of which management is aware that is relevant to the preparation and fair presentation of the financial statements, including an expectation that management will provide access to information relevant to disclosures*
- The agreement of management to make available to the auditor draft financial statements, *including all information relevant to their preparation and fair presentation, whether obtained from within or outside of the general and subsidiary ledgers (including all information relevant to the preparation and fair presentation of disclosures)*, and any accompanying other information,<sup>12</sup> in time to allow the auditor to complete the audit in accordance with the proposed timetable
- The agreement of management to inform the auditor of events occurring or facts discovered subsequent to the date of the financial statements, of which management may become aware, that may affect the financial statements
- The basis on which fees are computed and any billing arrangements
- A request for management to acknowledge receipt of the audit engagement letter and to agree to the terms of the engagement outlined therein, as may be evidenced by *management signing*~~'s their signature on~~ the engagement letter

<sup>10</sup> [Footnote omitted for purposes of this SAS.]

<sup>11</sup> [Footnote omitted for purposes of this SAS.]

<sup>12</sup> ***As defined in section 720, Other Information in Documents Containing Audited Financial Statements.***

[All subsequent footnotes are renumbered.]

*.A24 Although there is no requirement in GAAS to communicate key audit matters, the engagement letter may acknowledge that management has requested that the auditor communicate key audit matters in the auditor's report. If the terms of the audit engagement initially acknowledge that key audit matters will be communicated, but it is later decided that this will not be done, the engagement letter may need to be modified accordingly. If, after the engagement letter is signed, management requests that the auditor communicate key audit matters, the auditor may acknowledge this agreement in a new engagement letter or as an addendum to the originally signed letter.*

[Paragraphs .A24–.A41 are renumbered as paragraphs .A25–.A42. The content is unchanged.]

**Exhibit — Example of an Audit Engagement Letter (Ref: par. .A25A26)**

~~.A42.~~**A43** The following is an example of an audit engagement letter for an audit of general purpose financial statements prepared in accordance with accounting principles generally accepted in the United States of America, as promulgated by the Financial Accounting Standards Board. This letter is not authoritative but is intended only to be a guide that may be used in conjunction with the considerations outlined in this ~~Statement on Auditing Standards~~ ~~section~~. The letter will vary according to individual requirements and circumstances and is drafted to refer to the audit of financial statements for a single reporting period. The auditor may seek legal advice about whether a proposed letter is suitable.

To the appropriate representative of those charged with governance of ABC Company:<sup>1</sup>

*[The objective and scope of the audit]*

You<sup>2</sup> have requested that we audit the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements. We are pleased to confirm our acceptance and our understanding of this audit engagement by means of this letter.

~~Our audit will be conducted~~ *The objectives of our audit are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our* ~~with the objective of our expressing an opinion. on the financial statements.~~ *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 auditing standards generally accepted in the United States of America (GAAS) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users made on the basis of these financial statements.*

*[The responsibilities of the auditor]*

We will conduct our audit in accordance with ~~auditing standards generally accepted in the United States of America (GAAS).~~ *As part of an audit in accordance with GAAS, we exercise professional judgment and maintain professional skepticism throughout the audit.* ~~Those standards require that we plan and perform the audit to obtain reasonable~~

assurance about whether the financial statements are free from material misstatement. An audit involves ~~We also:~~

- ~~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~~ ***Identify and assess*** the risks of material misstatement of the financial statements, whether due to fraud or error, ***design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.***
- ~~In making our risk assessments, we consider~~ ***Obtain an understanding of*** internal control relevant to the ***audit*** entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.<sup>3</sup> However, we will communicate to you in writing concerning any significant deficiencies or material weaknesses in internal control relevant to the audit of the financial statements that we have identified during the audit.
- ~~An audit also includes e~~ ***Evaluating*** the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, ***as well as evaluate the overall presentation of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.***
- ***Conclude, based on the audit evidence obtained, whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.***
- ~~, as well as evaluateing the overall presentation of the financial statements.~~

Because of the inherent limitations of an audit, together with the inherent limitations of internal control, an unavoidable risk that some material misstatements may not be detected exists, even though the audit is properly planned and performed in accordance with GAAS.

[*The responsibilities of management and identification of the applicable financial reporting framework*]

Our audit will be conducted on the basis that [*management and, when appropriate, those charged with governance*]<sup>34</sup> acknowledge and understand that they have responsibility

*Amendments*

- a. for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America;
- b. for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; and
- c. to provide us with
  - i. access to all information of which [*management*] is aware that is relevant to the preparation and fair presentation of the financial statements such as records, documentation, and other matters;
  - ii. additional information that we may request from [*management*] for the purpose of the audit; and
  - iii. unrestricted access to persons within ABC Company from whom we determine it necessary to obtain audit evidence.

As part of our audit process, we will request from [*management and, when appropriate, those charged with governance*] written confirmation concerning representations made to us in connection with the audit.

[*Other relevant information*]

[*Insert other information, such as fee arrangements, billings, and other specific terms, as appropriate.*]

**[Reporting]**

[*Insert appropriate reference to the expected form and content of the auditor's report Example follows:*]

We will issue a written report upon completion of our audit of ABC Company's financial statements. Our report will be addressed to the board of directors of ABC Company. ~~We cannot provide assurance that an unmodified opinion will be expressed.~~ Circumstances may arise ***in which our report may differ from its expected form and content based on the results of our audit. Depending on the nature of these circumstances,*** ~~in which it is necessary for us to modify our opinion, add an emphasis-of-matter or other-matter paragraph(s), or it may be necessary for us to modify our opinion, add an emphasis-of-matter paragraph or other-matter paragraph to our auditor's report, or if necessary,~~ withdraw from the engagement.

We also will issue a written report on *[Insert appropriate reference to other auditor's reports expected to be issued.]* upon completion of our audit.

Please sign and return the attached copy of this letter to indicate your acknowledgment of, and agreement with, the arrangements for our audit of the financial statements including our respective responsibilities.

XYZ & Co.

Acknowledged and agreed on behalf of ABC Company by

\_\_\_\_\_

*[Signed]*

*[Name and Title]*

*[Date]*

<sup>1</sup>[Footnote omitted for purposes of this SAS.]

<sup>2</sup>[Footnote omitted for purposes of this SAS.]

<sup>3</sup> ***This sentence would be modified, as appropriate, in circumstances in which the auditor also has a responsibility to issue an opinion on the effectiveness of internal control over financial reporting in conjunction with the audit of the financial statements.***

<sup>34</sup>[Footnote omitted for purposes of this SAS.]

[All subsequent footnotes are renumbered.]

[No further amendments to AU-C section 210.]

**AU-C Section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards***

[No amendments to paragraphs .01–.21. Paragraph .22 included for contextual purposes only.]

**Engagement Quality Control Review**

**.22** The engagement quality control reviewer should perform an objective evaluation of the significant judgments made by the engagement team and the conclusions reached in formulating the auditor's report. This evaluation should involve

- a. discussion of significant findings or issues with the engagement partner;

- b. reading the financial statements and the proposed auditor's report;
- c. review of selected audit documentation relating to the significant judgments the engagement team made and the related conclusions it reached; and
- d. evaluation of the conclusions reached in formulating the auditor's report and consideration of whether the proposed auditor's report is appropriate. (Ref: par. ~~.A26–A32A34~~)

[No amendments to paragraphs .23–.A27.]

***.A28 When section 701, Communicating Key Audit Matters in the Independent Auditor's Report, of this SAS applies, the conclusions reached by the engagement team in formulating the auditor's report include determining the following:***

- *The key audit matters to be communicated*
- *The key audit matters that will not be communicated in the auditor's report in accordance with paragraph .13 of section 701 of this SAS, if any*
- *If applicable, depending on the facts and circumstances of the entity and the audit, that there are no key audit matters to communicate in the auditor's report*

***In addition, the reading of the proposed auditor's report in accordance with paragraph .22b includes consideration of the proposed descriptions of the matters to be included in the "Key Audit Matters" section.***

[No further amendments to AU-C section 220.]

#### **AU-C Section 230, Audit Documentation**

[No amendments to paragraphs .01–.A9.]

***Documentation of Significant Findings or Issues and Related Significant Professional Judgments (Ref: par. .08c)***

[No amendments to paragraphs .A10–.A11.]

**.A12** Some examples of circumstances in which, in accordance with paragraph .08, it is appropriate to prepare audit documentation relating to the exercise of professional judgment include, when the findings, issues, and judgments are significant,

- the rationale for the auditor's conclusion when a requirement provides that the auditor *should consider* certain information or factors, and that consideration is significant in the context of the particular engagement.

- the basis for the auditor’s conclusion on the reasonableness of areas of subjective judgments (for example, the reasonableness of significant accounting estimates).
- the basis for the auditor’s conclusions about the authenticity of a document when further investigation (such as making appropriate use of a specialist or of confirmation procedures) is undertaken in response to conditions identified during the audit that caused the auditor to believe that the document may not be authentic.
- ***when section 701, Communicating Key Audit Matters in the Independent Auditor’s Report, of this SAS applies, the auditor’s determination of the key audit matters or the determination that there are no key audit matters to be communicated, including in the extremely rare circumstances in which the auditor determines that the matter should not be communicated in the auditor’s report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication***

[No amendments to paragraphs .A13–.A29]

**Exhibit — Audit Documentation Requirements in Other AU-C Sections**

**.A30** The following lists the main paragraphs in other AU-C sections that contain specific documentation requirements. This list is not a substitute for knowledge of the AU-C sections:

- a. Paragraphs .10, .13, and .16 of section 210, *Terms of Engagement*
- b. Paragraphs .25–.26 of section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*
- c. Paragraphs .43–.46 of section 240, *Consideration of Fraud in a Financial Statement Audit*
- d. Paragraph .28 of section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*
- e. Paragraph .20 of section 260, *The Auditor’s Communication With Those Charged With Governance*
- f. Paragraph .12 of section 265, *Communicating Internal Control Related Matters Identified in an Audit*
- g. Paragraph .14 of section 300, *Planning an Audit*
- h. Paragraph .33 of section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*

<i>Amendments</i>
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- i.* Paragraph .14 of section 320, *Materiality in Planning and Performing an Audit*
- j.* Paragraphs .30–.33 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*
- k.* Paragraph .12 of section 450, *Evaluation of Misstatements Identified During the Audit*
- l.* Paragraph .20 of section 501, *Audit Evidence — Specific Considerations for Selected Items*
- m.* Paragraph .08 of section 520, *Analytical Procedures*
- n.* Paragraph .22 of section 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*
- o.* Paragraph .28 of section 550, *Related Parties*
- p.* Paragraph .22 of section 570, *The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern*
- q.* Paragraphs .49 and .64 of section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*
- r. Paragraphs .33–.35 of section 610, Using the Work of Internal Auditors***
- s. Paragraph .17 of section 701, Communicating Key Audit Matters in the Independent Auditor’s Report, of this SAS***
- ~~*t.*~~ Paragraph .13 of section 915, *Reports on Application of Requirements of an Applicable Financial Reporting Framework*
- ~~*u.*~~ Paragraphs .42–.43 of section 930, *Interim Financial Information*
- ~~*v.*~~ Paragraphs .39–.42 of section 935, *Compliance Audits*

[No further amendments to AU-C section 230.]

## AU-C Section 240, *Consideration of Fraud in a Financial Statement Audit*

[No amendments to paragraphs .01–.14.]

### **Discussion Among the Engagement Team**

**.15** Section 315 requires a discussion among the key engagement team members, including the engagement partner, and a determination by the engagement partner of which matters are to be communicated to those team members not involved in the discussion.<sup>4</sup> This discussion should include an exchange of ideas or brainstorming among the engagement team members about how and where the entity's financial statements (*including the individual statements and the disclosures*) might be susceptible to material misstatement due to fraud, how management could perpetrate and conceal fraudulent financial reporting, and how assets of the entity could be misappropriated. The discussion should occur setting aside beliefs that the engagement team members may have that management and those charged with governance are honest and have integrity, and should, in particular, also address (Ref: par. .A12–.A13)

...

<sup>4</sup> [Footnote omitted for the purposes of this SAS.]

[No amendments to paragraphs .15a–.A5.]

### **Characteristics of Fraud (Ref: par. 3)**

**.A6** Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls *intentionally* using such techniques as the following:

- Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives
- Inappropriately adjusting assumptions and changing judgments used to estimate account balances
- Omitting, advancing, or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period
- ***Omitting, obscuring, or misstating disclosures required by the applicable financial reporting framework or disclosures that are necessary to achieve fair presentation***
- ~~Concealing, or not disclosing,~~ facts that could affect the amounts recorded in the financial statements
- Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity
- Altering records and terms related to significant and unusual transactions

[No amendments to paragraphs .A7–.A12.]

**Discussion Among the Engagement Team (Ref: par. .15)**

**.A13** The discussion may lead to a thorough probing of the issues, acquiring of additional evidence as necessary, and consulting with other team members and, if appropriate, specialists in or outside the firm. The discussion may include the following matters:

- *A consideration of the risk that management may attempt to present disclosures in a manner that may obscure a proper understanding of the matters disclosed (for example, by using unclear or ambiguous language)*
- A consideration of management’s involvement in overseeing employees with access to cash or other assets susceptible to misappropriation
- A consideration of any unusual or unexplained changes in behavior or lifestyle of management or employees that have come to the attention of the engagement team
- A consideration of the types of circumstances that, if encountered, might indicate the possibility of fraud
- A consideration of how an element of unpredictability will be incorporated into the nature, timing, and extent of the audit procedures to be performed
- A consideration of the audit procedures that might be selected to respond to the susceptibility of the entity’s financial statements to material misstatement due to fraud and whether certain types of audit procedures are more effective than others
- A consideration of any allegations of fraud that have come to the auditor’s attention

[No further amendments to AU-C section 240.]

**AU-C Section 260, *The Auditor’s Communication With Those Charged With Governance***

**Introduction**

**Scope of This Section**

[No amendments to paragraphs .01–.02.]

**.03** Recognizing the importance of effective two-way communication in an audit of financial statements, this section provides an overarching framework for the auditor’s communication with those charged with governance and identifies some specific matters to be communicated. Additional matters to be communicated are identified in other AU-C sections (see the exhibit, “Requirements to Communicate With Those Charged With Governance in Other AU-C Sections”). In addition, section 265, *Communicating Internal Control Related Matters Identified in an Audit*, establishes specific requirements regarding the communication of significant deficiencies and material weaknesses in internal control the auditor has identified during the audit to those charged with governance. Further matters not required by generally accepted auditing standards (GAAS) may be required to be communicated by agreement with those charged with governance or management or in accordance with *law or regulation or*

*other* external requirements. Nothing in this section precludes the auditor from communicating any other matters to those charged with governance.

[No amendments to paragraphs .04–.09.]

## **Matters to Be Communicated**

### ***The Auditor’s Responsibilities With Regard to the Financial Statement Audit***

**.10** The auditor should communicate with those charged with governance the auditor’s responsibilities with regard to the financial statement audit, including that (Ref: par. ~~.A13–.A18~~~~A17~~)

*a.* the auditor is responsible for forming and expressing an opinion about whether the financial statements that have been prepared by management, with the oversight of those charged with governance, are prepared, in all material respects, in accordance with the applicable financial reporting framework.

*b.* the audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

### ***Planned Scope and Timing of the Audit***

**.11** The auditor should communicate with those charged with governance an overview of the planned scope and timing of the audit, ***which includes communicating about the significant risks identified by the auditor.*** (Ref: par. ~~.A18~~~~A19–.A22~~~~A24~~)

### ***Significant Findings or Issues From the Audit***

**.12** The auditor should communicate with those charged with governance (Ref: par. ~~.A23~~~~A25–.A26~~)

*a.* the auditor’s views about qualitative aspects of the entity’s significant accounting practices, including accounting policies, accounting estimates, and financial statement disclosures. When applicable, the auditor should (Ref: par. ~~.A24~~~~A27–.25~~~~A29~~)

*i.* explain to those charged with governance why the auditor considers a significant accounting practice that is acceptable under the applicable financial reporting framework not to be most appropriate to the particular circumstances of the entity and

*ii.* determine that those charged with governance are informed about the process used by management in formulating particularly sensitive accounting estimates, including fair value estimates, and about the basis for the auditor’s conclusions regarding the reasonableness of those estimates.

*b.* significant difficulties, if any, encountered during the audit. (Ref: par. ~~.A26~~~~A30~~)

*c.* disagreements with management, if any. (Ref: par. ~~.A28~~~~A31~~)

*d.* ***circumstances that affect the form and content of the auditor’s report, if any.*** (Ref: par. ~~.A32–.A33~~)

- ~~d~~e. other findings or issues, if any, arising ~~from~~*during* the audit that are, in the auditor's professional judgment, significant and relevant to those charged with governance regarding their responsibility to oversee the financial reporting process. (Ref: par. ~~A27.A34-.A36~~)

[No amendments to paragraph .13.]

*When Not All of Those Charged With Governance Are Involved in Management*

**.14** Unless all of those charged with governance are involved in managing the entity, the auditor also should communicate

- a. material, corrected misstatements that were brought to the attention of management as a result of audit procedures. (Ref: par. ~~.A31A39~~)
- b. significant findings or issues, ~~if any~~, arising ~~from~~*during* the audit that were discussed, or *were* the subject of correspondence, with management. (Ref: par. ~~.A32A40~~)
- c. the auditor's views about significant matters that were the subject of management's consultations with other accountants on accounting or auditing matters when the auditor is aware that such consultation has occurred.
- d. written representations the auditor is requesting. (Ref. par. ~~.A33A41~~)

[No amendments to paragraphs .15-.A12.]

**Matters to Be Communicated**

***The Auditor's Responsibilities With Regard to the Financial Statement Audit (Ref: par. .10)***

**.A13** The auditor's responsibilities with regard to the financial statement audit are often included in the engagement letter or other suitable form of written agreement that documents the terms of the engagement. ***Law, regulation, or the governance structure of the entity may require those charged with governance to agree upon the terms of the engagement with the auditor. When this is not the case, P***roviding those charged with governance with a copy of that engagement letter or other suitable form of written agreement may be an appropriate way to communicate with them ***regarding matters such as that the following:***

- ***That*** the auditor is responsible for performing the audit in accordance with GAAS ~~and that the audit is designed to obtain reasonable, rather than absolute, assurance about whether,~~ ***which are directed toward the expression of an opinion on the financial statements. The matters that GAAS require to be communicated, therefore, include significant matters arising during the audit of the financial statements as a whole are free from material misstatement that are relevant to those charged with governance in overseeing the financial reporting process:***
- ~~an audit of financial statements includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in~~

~~the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over financial reporting.~~

- ~~• the auditor is responsible for communicating significant matters related to the financial statement audit that are, in the auditor's professional judgment, relevant to the responsibilities of those charged with governance in overseeing the financial reporting process. ***The fact that*** GAAS do not require the auditor to design procedures for the purpose of identifying other matters to communicate with those charged with governance.~~
- ***That, when section 701, Communicating Key Audit Matters in the Independent Auditor's Report, of this SAS applies, the auditor is responsible for determining and communicating key audit matters in the auditor's report***
- ***That, when applicable, the auditor is also responsible for communicating particular matters required by law or regulation, by agreement with the entity, or by additional requirements applicable to the engagement.***

**Auditor Independence** (Ref: par. .10)

[No amendments to paragraphs .A14–.A16.]

***.A17 Relevant ethical requirements may also specify particular communications to those charged with governance in circumstances in which breaches of independence requirements have been identified. For example, the AICPA Code of Professional Conduct requires the auditor to communicate with those charged with governance in writing about any breach and the action the firm has taken or proposes to take.<sup>4</sup>***

***<sup>4</sup> The “Breach of an Independence Interpretation” interpretation (ET sec. 1.298.010),<sup>†</sup> under the “Independence Rule” (ET sec. 1.200.001) of the AICPA Code of Professional Conduct, addresses breaches of independence.***

[Paragraph .A17 is renumbered as paragraph .A18. The content is unchanged. Due to the arrangement of application material corresponding to paragraph .11, the following section has been reorganized.]

**Planned Scope and Timing of the Audit** (Ref: par. .11)

[Paragraph .A18 is renumbered and moved to paragraph .A24. No amendments to paragraph .A19.]

***.A20 Communicating significant risks identified by the auditor helps those charged with governance understand those matters and why they require special audit consideration. The communication about significant risks may assist those charged with governance in fulfilling their responsibility to oversee the financial reporting process.***

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<sup>†</sup> All ET sections can be found in AICPA *Professional Standards*.

~~A20~~.A21—Matters communicated **Other matters regarding the planned scope and timing of the audit** may include the following:

- How the auditor ~~proposes~~**plans** to address the significant risks of material misstatement, whether due to fraud or error.
- ***How the auditor plans to address areas of higher assessed risks of material misstatement.***
- The auditor’s approach to internal control relevant to the audit including, when applicable, whether the auditor will express an opinion on the effectiveness of internal control over financial reporting.
- The application of materiality in the context of an audit, as discussed in section 320, *Materiality in Planning and Performing an Audit*. ***The auditor may wish to focus more broadly on the factors considered by the auditor when determining materiality for purposes of the audit, rather than on specific thresholds or amounts.***
- ***The nature and extent of specialized skills or knowledge needed to perform the planned audit procedures or evaluate the audit results, including the use of an auditor’s specialist.***<sup>5</sup>
- ***When section 701, Communicating Key Audit Matters in the Independent Auditor’s Report, of this SAS applies, the auditor’s preliminary views about matters that may be areas of significant auditor attention in the audit and that therefore may be key audit matters.***
- ***The auditor’s planned approach to addressing the implications for the individual statements and the disclosures of any significant changes within the applicable financial reporting framework or in the entity’s environment, financial condition, or activities.***
- If the entity has an internal audit function, how the auditor and the internal auditors can work together in a constructive and complementary manner, including any planned use of the work of the internal audit function in obtaining audit evidence and the nature and extent of any planned use of internal auditors to provide direct assistance.

<sup>5</sup> See section 620, **Using the Work of an Auditor’s Specialist**.

~~A21~~.A22 Other planning matters that may be appropriate to discuss with those charged with governance include

- the views of those charged with governance about the following matters:
  - The appropriate persons in the entity’s governance structure with whom to communicate
  - The allocation of responsibilities between those charged with governance and management
  - The entity’s objectives and strategies and the related business risks that may result in material misstatements

- Matters those charged with governance consider as warranting particular attention during the audit and any areas for which they request additional procedures to be undertaken
- Significant communications *between the entity and* ~~with~~ regulators
- Other matters those charged with governance believe are relevant to the audit of the financial statements
- the attitudes, awareness, and actions of those charged with governance concerning
  - ~~(a)~~ the entity's internal control and its importance in the entity, including how those charged with governance oversee the effectiveness of internal control, and
  - ~~(b)~~ the detection or the possibility of fraud.
- the actions of those charged with governance in response to developments in law, accounting standards, corporate governance practices, and other related matters, *and the effect of such developments on, for example, the overall presentation, structure, and content of the financial statements, including the following:*
  - *The relevance, reliability, comparability, and understandability of the information presented in the financial statements*
  - *Whether all required information has been included in the financial statements, and whether such information has been appropriately classified, aggregated or disaggregated, and presented*
- the actions of those charged with governance in response to previous communications with the auditor.

[Paragraph .A22 is renumbered as paragraph .A23. The content is unchanged.]

~~.A18~~**.A24** Care is ~~required~~ *necessary* when communicating with those charged with governance about the planned scope and timing of the audit so as not to compromise the effectiveness of the audit, particularly when some or all of those charged with governance are involved in managing the entity. For example, communicating the nature and timing of detailed audit procedures may reduce the effectiveness of those procedures by making them too predictable. Certain factors described in paragraph .A39**.A47** may be relevant in determining the nature and extent of this communication.

***Significant Findings From the Audit (Ref: par. .12)***

[Paragraph .A23 is renumbered as paragraph .A25. The content is unchanged.]

**.A26** *When section 701, Communicating Key Audit Matters in the Independent Auditor's Report, of this SAS applies, the communications with those charged with governance required by paragraph .12, as well as the communication about the significant risks identified by the auditor required by paragraph .11, are particularly relevant to the*

*auditor's determination of matters that required significant auditor attention and that therefore may be key audit matters.*<sup>6</sup>

<sup>6</sup> *Paragraphs .08–.09 of section 701, Communicating Key Audit Matters in the Independent Auditor's Report, of this SAS.*

[Subsequent footnote renumbered.]

*Qualitative Aspects of the Entity's Significant Accounting Practices (Ref: par. .12a)*

~~.A24~~**A27** Financial reporting frameworks ordinarily allow for the entity to make accounting estimates and judgments about accounting policies and financial statement disclosures, *for example, the use of key assumptions in the development of accounting estimates for which there is significant measurement uncertainty. In addition, law, regulation, or financial reporting frameworks may require disclosure of a summary of significant accounting policies or make reference to "critical accounting estimates" or "critical accounting policies and practices" to identify and provide additional information to users about the most difficult, subjective, or complex judgments made by management in preparing the financial statements.*

*.A28 As a result, the auditor's views on the subjective aspects of the financial statements may be particularly relevant to those charged with governance in discharging their responsibilities for oversight of the financial reporting process. For example, in relation to the matters described in paragraph .A27, those charged with governance may be interested in the auditor's evaluation of the adequacy of disclosures of the estimation uncertainty relating to accounting estimates that give rise to significant risks and the quality of the disclosures.* Open and constructive communication about qualitative aspects of the entity's significant accounting practices may *also* include comment on the acceptability of significant accounting practices *and the quality of the disclosures*. The appendix, "Qualitative Aspects of Accounting Practices," identifies matters that may be included in this communication.

[Paragraph .A25 is renumbered as paragraph .A29. The content is unchanged.]

*Significant Difficulties Encountered During the Audit (Ref: par. .12b)*

~~.A26~~**A30** Significant difficulties encountered during the audit may include matters such as

- significant delays ~~in management providing required information~~*by management, the unavailability of entity personnel, or an unwillingness by management to provide information necessary to perform the auditor's procedures.*
- an ~~unnecessarily~~*unreasonably* brief time within which to complete the audit.
- extensive unexpected effort required to obtain sufficient appropriate audit evidence.
- the unavailability of expected information.
- restrictions imposed on the auditor by management.
- management's unwillingness to ~~provide information about management's plans for dealing with the adverse effects of the conditions or events that lead the~~

~~auditor to believe there is substantial doubt about~~***perform or extend its evaluation of the entity's ability to continue as a going concern to meet the period of time required by the applicable financial reporting framework when requested.***

In some circumstances, such difficulties may constitute a scope limitation that leads to a modification of the auditor's opinion.

*Disagreements With Management (Ref: par. .12c)*

[Paragraph .A27 renumbered and moved to paragraph .A34. Paragraph .A28 is renumbered as paragraph .A31. The content is unchanged.]

***Circumstances That Affect the Form and Content of the Auditor's Report (Ref: par. .12d)***

***.A32 Section 210, Terms of Engagement, requires the auditor to agree upon the terms of the audit engagement with management or those charged with governance, as appropriate.<sup>8</sup> The agreed terms of the audit engagement are required to be recorded in an audit engagement letter or other suitable form of written agreement and include, among other things, reference to the expected form and content of the auditor's report.<sup>9</sup> As explained in paragraph .A13, if the terms of engagement are not agreed upon with those charged with governance, the auditor may provide those charged with governance with a copy of the engagement letter in order to communicate about matters relevant to the audit. The communication required by paragraph .12d is intended to inform those charged with governance about circumstances in which the auditor's report may differ from its expected form and content or may include additional information about the audit that was performed.***

<sup>8</sup> *Paragraph .09 of section 210, Terms of Engagement.*

<sup>9</sup> *Paragraph .10 of section 210.*

***.A33 Circumstances in which the auditor is required or may otherwise consider it necessary to include additional information in the auditor's report in accordance with GAAS, and for which communication with those charged with governance is required, include the following:***

- ***The auditor expects to modify the opinion in the auditor's report in accordance with section 705, Modifications to the Opinion in the Independent Auditor's Report, of this SAS.<sup>10</sup>***
- ***A "Going Concern" section is included in the auditor's report in accordance with section 570, The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern.<sup>11</sup>***
- ***Key audit matters are communicated in accordance with section 701, Communicating Key Audit Matters in the Independent Auditor's Report, of this SAS.<sup>12</sup>***
- ***The auditor considers it necessary to include an emphasis-of-matter paragraph or other-matter paragraph in accordance with section 706, Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report, of this SAS<sup>13</sup> or is required to do so by other AU-C sections.***

*In such circumstances, the auditor may consider it useful to provide those charged with governance with a draft of the auditor's report to facilitate a discussion of how such matters will be addressed in the auditor's report.*

<sup>10</sup> *Paragraph .31 of section 705, Modifications to the Opinion in the Independent Auditor's Report, of this SAS.*

<sup>11</sup> *Paragraphs .24 and .28 of section 570, The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern.*

<sup>12</sup> *Paragraph .16 of section 701, Communicating Key Audit Matters in the Independent Auditor's Report, of this SAS.*

<sup>13</sup> *Paragraph .12 of section 706, Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report, of this SAS.*

*Other Findings or Issues*

~~A27~~**A34** The auditor may become aware that the entity is subject to an audit requirement that is not encompassed in the terms of the engagement. The communication to those charged with governance that an audit conducted in accordance with GAAS may not satisfy the relevant legal, regulatory, or contractual requirements may be necessary if, for example, an entity engages an auditor to perform an audit of its financial statements in accordance with GAAS and the auditor becomes aware that by law, regulation, or contractual agreement the entity also is required to have an audit performed in accordance with one or more of the following:

- a. *Government Auditing Standards*
- b. ~~OMB Circular A-133, Audits of States, Local Governments~~ **Title 2 U.S. Code of Federal Regulations Part 200, Uniform Administration Requirements, Cost Principles, and Non-Profit Organizations—Audit Requirements for Federal Awards**
- c. Other compliance audit requirements, such as state or local laws or program-specific audits under federal audit guides

*Other Significant Matters Relevant to the Financial Reporting Process (Ref: par. .12e)*

~~A35~~ **A35** *Section 300, Planning an Audit,*<sup>14</sup> *notes that, as a result of unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy and audit plan and, thereby, the resulting planned nature, timing, and extent of further audit procedures, based on the revised consideration of assessed risks. The auditor may communicate with those charged with governance about such matters as, for example, an update to initial discussions about the planned scope and timing of the audit.*

<sup>14</sup> *Paragraph .A15 of Section 300, Planning an Audit.*

~~A36~~ **A36** *To the extent not already addressed by the requirements in paragraph .12a–d and related application material, the auditor may consider communicating about other matters discussed with, or considered by, the engagement quality control reviewer, if one has been appointed, in accordance with section 220, Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.*<sup>15</sup>

***<sup>15</sup> Paragraphs .21–.22 of section 220, Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.***

[Paragraphs .A29–.A31 are renumbered as paragraphs .A37–.A39. The content is unchanged.]

*Significant Findings or Issues Discussed or Subject to Correspondence With Management (Ref: par. .14b)*

***.A32A40*** Significant findings or issues discussed, or the subject of correspondence, with management may include matters such as

- ***significant events or transactions that occurred during the year.***
- business conditions affecting the entity and business plans and strategies that may affect the risks of material misstatement.
- discussions or correspondence in connection with the initial or recurring engagement of the auditor including, among other matters, any discussions or correspondence regarding accounting practices or the application of auditing standards.

[Paragraphs .A33–.A38 are renumbered as paragraphs .A41–.A46. The content is unchanged.]

***Forms of Communication (Ref: par. .16)***

[Paragraph .A39 is renumbered as paragraph .A47. The content is unchanged.]

***.A40A48*** In addition to the significance of a particular matter, the form of communication (for example, whether to communicate orally or in writing, the extent of detail or summarization in the communication, and whether to communicate in a formal or informal manner) may be affected by factors such as

- ***whether a discussion of the matter will be included in the auditor’s report. (For example, when key audit matters are communicated in the auditor’s report, the auditor may consider it necessary to communicate in writing about the matters determined to be key audit matters.)***
- whether the matter has been satisfactorily resolved.
- whether management has previously communicated the matter.
- the size, operating structure, control environment, and legal structure of the entity being audited.
- ***in the case of an audit of special purpose financial statements, whether the auditor also audits the entity’s general purpose financial statements.***
- legal or regulatory requirements that may require a written communication with those charged with governance.
- the expectations of those charged with governance, including arrangements made for periodic meetings or communications with the auditor.

- the amount of ongoing contact and dialogue the auditor has with those charged with governance.
- whether there have been significant changes in the membership of a governing body.  
~~in the case of an audit of special purpose financial statements, whether the auditor also audits the entity's general purpose financial statements.~~

[Paragraph .A41 is renumbered as paragraph .A49. The content is unchanged.]

***Timing of Communications (Ref: par. .18)***

~~.A42-.A50.—~~***The Timely communication throughout the audit contributes to the achievement of robust two-way dialogue between those charged with governance and the auditor. However, the appropriate timing for communications will vary with the circumstances of the engagement. Considerations include the significance and nature of the matter, the importance of the matter to those charged with governance, and the action expected to be taken by those charged with governance. The auditor may consider communicating—The following are examples of the timing of communications for certain matters:***

- ***Communications regarding*** planning matters ***may often be made*** early in the audit engagement and, for an initial engagement, as part of the terms of the engagement.
- ***It may be appropriate to communicate*** significant difficulties encountered during the audit as soon as practicable if those charged with governance are able to assist the auditor in overcoming the difficulties or if the difficulties are likely to lead to a modified opinion.
- ***Communications regarding independence may be appropriate whenever significant judgments are made about threats to independence and related safeguards.***
- ***When section 701, Communicating Key Audit Matters in the Independent Auditor's Report, of this SAS applies, the auditor may communicate preliminary views about key audit matters when discussing the planned scope and timing of the audit (see paragraph .A21); the auditor may also have more frequent communications to further discuss such matters when communicating about significant audit findings.***

***The following are examples of matters for which communication with those charged with governance may be important prior to issuance of the auditor's report:***

- ***Uncorrected misstatements accumulated by the auditor and the effect that they may have, individually or in the aggregate, on the opinion in the auditor's report, including possible implications with respect to future financial statements***
- ***Circumstances or relationships to which the auditor gave significant consideration relating to independence in reaching the conclusion that independence has not been impaired***
- ***Significant findings or issues from the audit, including the auditor's views about the qualitative aspects of the entity's accounting practices***

- *An expectation by the auditor that the opinion in the auditor’s report will be modified in accordance with section 705, Modifications to the Opinion in the Independent Auditor’s Report, of this SAS<sup>16</sup>*
- *When section 706, Communicating Key Audit Matters in the Independent Auditor’s Report, of this SAS applies, the matters planned to be included in the auditor’s report*

<sup>16</sup> *Paragraph .31 of section 705, Modifications to the Opinion in the Independent Auditor’s Report, of this SAS.*

[Paragraphs .A43–.A48 are renumbered as paragraphs .A51–.A56. The content is unchanged.]

### **Exhibit — Requirements to Communicate With Those Charged With Governance in Other AU-C Sections**

~~A49–A57~~ Requirements for the auditor to communicate with those charged with governance are included in other AU-C sections. This section does not change the requirements in

- a. paragraph .17 of section 210, *Terms of Engagement*
- b. paragraphs .21, .38ci, and .39–.41 of section 240, *Consideration of Fraud in a Financial Statement Audit*
- c. paragraphs .14, .18, and .21–.23 of section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*
- d. paragraph .11 of section 265, *Communicating Internal Control Related Matters Identified in an Audit*
- e. paragraph .27 of section 550, *Related Parties*
- f. paragraphs .10b–c, .12a, .15a, .17a, and .18 of section 560, *Subsequent Events and Subsequently Discovered Facts*
- g. paragraph ~~.49~~**28** of section 570, *The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern*
- h. paragraphs .45–.48 of section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*
- i. **paragraph .28 of section 610, Using the Work of Internal Auditors**

**j. paragraph .16 of section 701, Communicating Key Audit Matters in the Independent Auditor's Report, of this SAS**

~~i.k.~~ paragraphs .12, .14, ~~.20.24~~, and ~~.29.31~~ of section 705, *Modifications to the Opinion in the Independent Auditor's Report, of this SAS*

~~j.l.~~ paragraph ~~.09.12~~ of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report, of this SAS*

~~k.m.~~ paragraphs .08, .12, .15, and .18 of section 720, *Other Information in Documents Containing Audited Financial Statements*

~~l.n.~~ paragraph .06 of section 730, *Required Supplementary Information*

~~m.o.~~ paragraphs .23–.28 of section 930, *Interim Financial Information*

~~n.p.~~ paragraphs .36–.37 of section 935, *Compliance Audits*

**AU-C Section 300, *Planning an Audit***

**Requirements**

[No amendments to paragraphs .01–.A14.]

**Planning Activities**

...

***The Audit Plan (Ref: par. .09)***

***.A15 Determining the nature, timing, and extent of planned risk assessment procedures, and further audit procedures, as they relate to disclosures is important in light of both the wide range of information and the level of detail that may be encompassed in those disclosures. Further, certain disclosures may contain information that is obtained from outside of the general and subsidiary ledgers, which may also affect the assessed risks and the nature, timing, and extent of audit procedures to address them.***

***.A16 Consideration of disclosures early in the audit assists the auditor in giving appropriate attention to, and planning adequate time for, addressing disclosures in the same way as classes of transactions, events, and account balances are addressed. Early consideration may also help the auditor to determine the effects on the audit of the following:***

- ***Significant new or revised disclosures required as a result of changes in the entity's environment, financial condition, or activities (for example, disclosures about discontinued operations or a significant business combination)***
- ***Significant new or revised disclosures arising from changes in the applicable financial reporting framework***
- ***The need for the involvement of an auditor's specialist to assist with audit procedures related to particular disclosures (for example, disclosures related to pension or other retirement benefit obligations)***
- ***Matters relating to disclosures that the auditor may wish to discuss with those charged with governance<sup>3</sup>***

**<sup>3</sup>Paragraph .A13 of section 260, The Auditor's Communication With Those Charged With Governance.**

[Paragraphs .A15–.A24 are renumbered as paragraphs .A17–.A26. The content is unchanged.]

**Appendix — Considerations in Establishing the Overall Audit Strategy (Ref: par. .07–.08 and .A9–.A12)**

**.A25.A27**

...

**Significant Factors, Preliminary Engagement Activities, and Knowledge Gained on Other Engagements**

The following examples illustrate significant factors, preliminary engagement activities, and knowledge gained on other engagements:

- The determination of materiality, in accordance with section 320, *Materiality in Planning and Performing an Audit*, and, when applicable, the following:
  - The determination of materiality for components and communication thereof to component auditors in accordance with section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*
  - The preliminary identification of significant components and material classes of transactions, account balances, and disclosures
- Preliminary identification of areas in which there may be a higher risk of material misstatement
- The effect of the assessed risk of material misstatement at the overall financial statement level on direction, supervision, and review
- The manner in which the auditor emphasizes to engagement team members the need to maintain a questioning mind and exercise professional skepticism in gathering and evaluating audit evidence
- Results of previous audits that involved evaluating the operating effectiveness of internal control, including the nature of identified deficiencies and action taken to address them
- The discussion of matters that may affect the audit with firm personnel responsible for performing other services to the entity
- Evidence of management's commitment to the design, implementation, and maintenance of sound internal control, including evidence of appropriate documentation of such internal control
- *Changes within the applicable financial reporting framework, such as changes in accounting standards, which may involve significant new or revised disclosures*

## *Amendments*

- Volume of transactions, which may determine whether it is more efficient for the auditor to rely on internal control
- Importance attached to internal control throughout the entity to the successful operation of the business
- *The processes management uses to identify and prepare the disclosures required by the applicable financial reporting framework, including disclosures containing information that is obtained from outside of the general and subsidiary ledgers*
- Significant business developments affecting the entity, including changes in IT and business processes; changes in key management; and acquisitions, mergers, and divestments
- Significant industry developments, such as changes in industry regulations and new reporting requirements
- ~~Significant changes in the financial reporting framework, such as changes in accounting standards.~~
- Other significant relevant developments, such as changes in the legal environment affecting the entity

**AU-C Section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement***

[No amendments to paragraphs .01–.18.]

***The Required Understanding of the Entity and Its Environment, Including the Entity’s Internal Control***

*The Entity’s Internal Control*

Components of Internal Control

**.19** *The information system, including the related business processes relevant to financial reporting and communication.* The auditor shall obtain an understanding of the information system, including the related business processes relevant to financial reporting, including the following areas:

- a. The classes of transactions in the entity’s operations that are significant to the financial statements.
- b. The procedures within both IT and manual systems by which those transactions are initiated, authorized, recorded, processed, corrected as necessary, transferred to the general ledger, and reported in the financial statements.
- c. The related accounting records supporting information and specific accounts in the financial statements 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 general ledger. The records may be in either manual or electronic form.
- d. How the information system captures events and conditions, other than transactions, that are significant to the financial statements.
- e. The financial reporting process used to prepare the entity’s financial statements, including significant accounting estimates and disclosures.
- f. Controls surrounding journal entries, including nonstandard journal entries used to record nonrecurring, unusual transactions, or adjustments. (~~Ref: par. .A92–.A96~~)

***This understanding of the information system relevant to financial reporting should include relevant aspects of that system relating to information disclosed in the financial statements that is obtained from within or outside of the general and subsidiary ledgers. (Ref: par. .A92–.A96)***

[No amendments to paragraphs .20–.26.]

**Identifying and Assessing the Risk of Material Misstatement**

.27 For this purpose, the auditor should

- a. identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures (***including the quantitative and qualitative aspects of such disclosures***) in the financial statements; (Ref: par. ~~A134–A135.A139–A143~~)
- b. assess the identified risks and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions;
- c. relate the identified risks to what can go wrong at the relevant assertion level, taking account of relevant controls that the auditor intends to test; and (Ref: par. ~~A136–A138.A144–A146~~)
- d. consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is ~~of a magnitude that~~ could result in a material misstatement. (***Ref: par. A147***)

[No amendments to paragraphs .28–.33.]

## Application and Other Explanatory Material

### Risk Assessment Procedures and Related Activities (Ref: par. .05)

**.A1** Obtaining an understanding of the entity and its environment, including the entity’s internal control (referred to hereafter as an understanding of the entity), is a continuous, dynamic process of gathering, updating, and analyzing information throughout the audit. The understanding of the entity establishes a frame of reference within which the auditor plans the audit and exercises professional judgment throughout the audit when, for example,

- assessing risks of material misstatement of the financial statements;
- determining materiality in accordance with section 320, *Materiality in Planning and Performing an Audit*;
- considering the appropriateness of the selection and application of accounting policies and the adequacy of financial statement disclosures;
- identifying areas ***relating to amounts or disclosures in the financial statements*** for which special audit consideration may be necessary (for example, related party transactions, ~~the appropriateness of~~ ***or management’s use of the evaluation of the entity’s ability to continue as a going concern assumption, or when*** considering the business purpose of transactions, ~~or the existence of complex and unusual transactions~~);
- developing expectations for use when performing analytical procedures;

- responding to the assessed risks of material misstatement, including designing and performing further audit procedures to obtain sufficient appropriate audit evidence; and
- evaluating the sufficiency and appropriateness of audit evidence obtained, such as the appropriateness of assumptions and management's oral and written representations.

[No amendments to paragraphs .A2–.A18.]

*Information Obtained in Prior Periods (Ref: par. .10)*

**.A19** The auditor's previous experience with the entity and audit procedures performed in previous audits may provide the auditor with information about such matters as

- past misstatements and whether they were corrected on a timely basis.
- the nature of the entity and its environment and the entity's internal control (including deficiencies in internal control).
- significant changes that the entity or its operations may have undergone since the prior financial period, which may assist the auditor in gaining a sufficient understanding of the entity to identify and assess risks of material misstatement.
- *those particular types of transactions and other events or account balances (and related disclosures) that, for example, due to their complexity, resulted in the auditor having difficulty in performing the necessary audit procedures.*

**.A20** *As part of the discussion among the engagement team required by paragraph .11, consideration of the disclosure requirements of the applicable financial reporting framework assists in identifying early in the audit where there may be risks of material misstatement related to disclosures. Examples of matters the engagement team may discuss include the following:*

- *Changes in financial reporting requirements that may result in significant new or revised disclosures*
- *Changes in the entity's environment, financial condition, or activities that may result in significant new or revised disclosures, for example, a significant business combination in the period under audit*
- *Disclosures for which obtaining sufficient appropriate audit evidence may have been difficult in the past*
- *Disclosures about complex matters, including those involving significant management judgment regarding what information to disclose*

[Paragraphs .A20–.A26 are renumbered as paragraphs .A21–A27. The content is unchanged.]

***The Required Understanding of the Entity and Its Environment, Including the Entity’s Internal Control***

The Entity and Its Environment

*Industry, Regulatory, and Other External Factors (Ref: par. .12a)*

~~A27~~.**A28** *Regulatory factors.* Relevant regulatory factors include the regulatory environment. The regulatory environment encompasses, among other matters, the applicable financial reporting framework and the legal and political environment. Examples of matters the auditor may consider include the following:

- Accounting principles and industry-specific practices
- Regulatory framework for a regulated industry, ***including requirements for disclosures***
- Laws and regulations that significantly affect the entity’s operations, including direct supervisory activities
- Taxation (corporate and other)
- Government policies currently affecting the conduct of the entity’s business, such as monetary (including foreign exchange controls), fiscal, financial incentives (for example, government aid programs), and tariffs or trade restrictions policies
- Environmental requirements affecting the industry and the entity’s business

[Paragraphs .A28–.A29 are renumbered as paragraphs .A29–.A30. The content is unchanged.]

*Nature of the Entity (Ref: par. .12b)*

~~A30~~.**A31** An understanding of the nature of an entity enables the auditor to understand such matters as

- whether the entity has a complex structure (for example, with subsidiaries or other components in multiple locations). Complex structures often introduce issues that may give rise to risks of material misstatement. Such issues may include whether goodwill, joint ventures, investments, or investments in entities formed to accomplish specific objectives are accounted for ***and disclosed*** appropriately.
- the ownership, and relationships between owners and other people or entities. This understanding assists in determining whether related party transactions have been ***appropriately*** identified, and accounted for, ~~appropriately~~ ***and adequately disclosed in the financial statements***. Section 550, *Related Parties*, addresses the auditor’s considerations relevant to related parties.

~~A31~~.**A32** Examples of matters that the auditor may consider when obtaining an understanding of the nature of the entity include

- business operations such as

...

- investments and investment activities such as
- ...
- financing and financing activities such as
- ...
- financial reporting *practices* such as
  - accounting principles and industry-specific practices, including *for* industry-specific significant categories *classes of transactions, account balances, and related disclosures in the financial statements* (for example, loans and investments for banks or research and development for pharmaceuticals).
  - revenue recognition ~~practices~~.
  - accounting for fair values.
  - foreign currency assets, liabilities, and transactions.
  - accounting for unusual or complex transactions, including those in controversial or emerging areas (for example, accounting for stock-based compensation).

[Paragraphs .A32–.A81 are renumbered as paragraphs .A33–.A82. The content is unchanged.]

*Components of Internal Control — Control Environment (Ref: par. .15)*

~~A82.~~**A83** *Effect of the control environment on the assessment of the risks of material misstatement.* Some elements of an entity’s control environment have a pervasive effect on assessing the risks of material misstatement. For example, an entity’s control consciousness is influenced significantly by those charged with governance, because one of their roles is to counterbalance pressures on management in relation to financial reporting that may arise from market demands or remuneration schemes. The effectiveness of the design of the control environment in relation to participation by those charged with governance is therefore influenced by such matters as

- their independence from management and their ability to evaluate the actions of management.
- whether they understand the entity’s business transactions.
- the extent to which they evaluate whether the financial statements are prepared in accordance with the applicable financial reporting framework, *including whether the financial statements include adequate disclosures.*

[Paragraphs .A83–.A92 are renumbered as paragraphs .A84–.A93. The content is unchanged.]

*Components of Internal Control — The Information System, Including Related Business Processes Relevant to Financial Reporting and Communication*

***.A94 Financial statements may contain information that is obtained from outside of the general and subsidiary ledgers. Examples of such information may include the following:***

- *Information obtained from lease agreements disclosed in the financial statements, such as renewal options or future lease payments*
- *Information disclosed in the financial statements that is produced by an entity's risk management system*
- *Fair value information produced by management's specialists and disclosed in the financial statements*
- *Information disclosed in the financial statements that has been obtained from models or from other calculations used to develop estimates recognized or disclosed in the financial statements, including information relating to the underlying data and assumptions used in those models, such as the following:*
  - *Assumptions developed internally that may affect an asset's useful life*
  - *Data, such as interest rates, that are affected by factors outside the control of the entity*
- *Information disclosed in the financial statements about sensitivity analyses derived from financial models that demonstrates that management has considered alternative assumptions*
- *Information recognized or disclosed in the financial statements that has been obtained from an entity's tax returns and records*
- *Information disclosed in the financial statements that has been obtained from analyses prepared to support management's evaluation of the entity's ability to continue as a going concern, such as disclosures, if any, related to events or conditions that have been identified that raise substantial doubt about the entity's ability to continue as a going concern<sup>14</sup>*

<sup>14</sup> See paragraphs .21–.22 of section 570.

***.A95 The understanding of the information system relevant to financial reporting required by paragraph .19 of this section (including the understanding of relevant aspects of that system relating to information disclosed in the financial statements that is obtained from within or outside of the general and subsidiary ledgers) is a matter of the auditor's professional judgment. For example, certain amounts or disclosures in the entity's financial statements (such as disclosures about credit risk, liquidity risk, and market risk) may be based on information obtained from the entity's risk management system. However, the auditor is not required to understand all aspects of the risk management system and uses professional judgment in determining the necessary understanding.***

[Paragraphs .A93–.A95 are renumbered as paragraphs .A96–.A98. The content is unchanged. Subsequent footnotes are renumbered.]

~~.A96.~~**.A99** *Considerations specific to smaller, less complex entities. (Ref: par. .19). The information systems, and related business processes, relevant to financial reporting in small entities, including relevant aspects of that system relating to information disclosed in the financial statements that is obtained from within or outside of the general and subsidiary ledgers, are is likely to be less sophisticated than in larger entities, but their its role is just as significant. Small entities with active management involvement may not need extensive descriptions of accounting procedures, sophisticated accounting records, or written policies. Understanding the entity’s information systems relevant to financial reporting and processes may therefore be easier in an audit of smaller entities, and may be more dependent on inquiry than on review of documentation. The need to obtain an understanding, however, remains important.*

[Paragraphs .A97–.A102 are renumbered as paragraphs .A100–.A105. The content is unchanged.]

*Components of Internal Control — Control Activities (Ref: [par. .21](#))*

**.A106** *Control activities relevant to the audit may include controls established by management that address risks of material misstatement related to disclosures not being prepared in accordance with the applicable financial reporting framework, in addition to controls that address risks related to account balances and transactions. Such control activities may relate to information included in the financial statements that is obtained from outside of the general and subsidiary ledgers.*

[Paragraphs .A103–.A122 are renumbered as paragraphs .A107–.A126. The content is unchanged.]

### **Identifying and Assessing the Risks of Material Misstatement**

*Assessment of Risks of Material Misstatement at the Financial Statement Level (Ref: par. .26a)*

~~.A123.~~**.A127** Risks at the financial statement level may derive, in particular, from a deficient control environment (although these risks may also relate to other factors, such as declining economic conditions). For example, deficiencies such as ~~management’s~~ **a lack of management competence or a lack of oversight over the preparation and fair presentation of the financial statements** may have a more pervasive effect on the financial statements and may require an overall response by the auditor.

[Paragraphs .A124–.A126 are renumbered as paragraphs .A128–.A130. The content is unchanged.]

*The Use of Assertions*

~~.A127.~~**.A131** In representing that the financial statements are in accordance with the applicable financial reporting framework, management implicitly or explicitly makes assertions regarding the

recognition, measurement, **and** presentation *of classes of transactions and events, account balances*, and disclosures ~~of the various elements of financial statements and related disclosures.~~

[Paragraph .A129 is renumbered and moved to paragraph .A132.]

~~.A129.~~**.A132** The auditor may use the assertions as described ~~above~~ *in paragraph .A133a–b* or may express them differently provided all aspects described ~~above~~ *in paragraph .A133* have been covered. For example, the auditor may choose to combine the assertions about *classes of transactions and events, and related disclosures*, with the assertions about account balances, *and related disclosures*. As another example, there may not be a separate assertion related to cutoff of transactions and events when the occurrence and completeness assertions include appropriate consideration of recording transactions in the correct accounting period.

#### ***Assertions About Classes of Transactions, Account Balances, and Related Disclosures***

~~.A128.~~**.A133** Assertions used by the auditor ~~to~~ *in considering* the different types of potential misstatements that may occur *may* fall into the following ~~three categories and may take the following forms:~~

- a. Assertions about classes of transactions and events, *and related disclosures*, for the period under audit, such as the following:
  - i. *Occurrence*. Transactions and events that have been recorded *or disclosed* have occurred, and *such transactions and events* pertain to the entity.
  - ii. *Completeness*. All transactions and events that should have been recorded have been recorded, *and all related disclosures that should have been included in the financial statements have been included*.
  - iii. *Accuracy*. Amounts and other data relating to recorded transactions and events have been recorded appropriately, *and related disclosures have been appropriately measured and described*.
  - iv. *Cutoff*. Transactions and events have been recorded in the correct accounting period.
  - v. *Classification*. Transactions and events have been recorded in the proper accounts.
  - vi. **Presentation**. *Transactions and events are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework*.
- b. Assertions about account balances, *and related disclosures*, at the period end, such as the following:
  - i. *Existence*. Assets, liabilities, and equity interests exist.
  - ii. *Rights and obligations*. The entity holds or controls the rights to assets, and liabilities are the obligations of the entity.
  - iii. *Completeness*. All assets, liabilities, and equity interests that should have been recorded have been recorded, *and all related disclosures that should have been included in the financial statements have been included*.

- iv. **Accuracy, ~~valuation~~, and allocation.** Assets, liabilities, and equity interests ~~are~~ ***have been included*** in the financial statements at appropriate amounts, ~~and~~ any resulting valuation or allocation adjustments ~~are~~ ***have been*** appropriately recorded, ***and related disclosures have been appropriately measured and described.***
  - v. **Classification.** ***Assets, liabilities, and equity interests have been recorded in the proper accounts.***
  - vi. **Presentation.** ***Assets, liabilities, and equity interests are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.***
- e. ~~Assertions about presentation and disclosure, such as the following:~~
- i. ~~Occurrence and rights and obligations—disclosed events, transactions, and other matters have occurred and pertain to the entity.~~
  - ii. ~~Completeness— all disclosures that should have been included in the financial statements have been included.~~
  - iii. ~~Classification and understandability— financial information is appropriately presented and described, and disclosures are clearly expressed.~~
  - iv. ~~Accuracy and valuation— financial and other information are disclosed fairly and at appropriate amounts.~~

#### ***Assertions About Other Disclosures***

***.A134*** ***The assertions described in paragraph .A133a–b, adapted as appropriate, may also be used by the auditor in considering the different types of potential misstatements that may occur in disclosures not directly related to recorded classes of transactions, events, or account balances. As an example of such a disclosure, the entity may be required to describe its exposure to risks arising from financial instruments, including how the risks arise; the objectives, policies, and processes for managing the risks; and the methods used to measure the risks.***

[Paragraphs .A130–.A133 are renumbered as paragraphs .A135–.A138. The content is unchanged.]

#### **Process of Identifying Risks of Material Misstatement (Ref: par. .27a)**

~~.A134.~~***A139*** Information gathered by performing risk assessment procedures, including the audit evidence obtained in evaluating the design of controls and determining whether they have been implemented, is used as audit evidence to support the risk assessment. The risk assessment determines the nature, timing, and extent of further audit procedures to be performed. ***In identifying the risks of material misstatement in the financial statements, the auditor exercises professional skepticism in accordance with section 200.***<sup>5</sup>

<sup>5</sup> ***Paragraph .17 of section 200.***

~~A135~~.A140 Appendix C provides examples of conditions and events that may indicate the existence of risks of material misstatement, ***including risks of material misstatement relating to disclosures***.

*.A141 As explained in section 320,<sup>6</sup> materiality and audit risk are considered when identifying and assessing the risks of material misstatement in classes of transactions, account balances, and disclosures. The auditor's determination of materiality is a matter of professional judgment and is affected by the auditor's perception of the financial reporting needs of users of the financial statements.<sup>7</sup>*

<sup>6</sup> Paragraph .A1 of section 320.

<sup>7</sup> Paragraph .04 of section 320.

*.A142 The auditor's consideration of disclosures in the financial statements when identifying risks includes quantitative and qualitative disclosures, the misstatement of which could be material (in general, misstatements are considered to be material if they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements as a whole). Depending on the circumstances of the entity and the engagement, examples of disclosures that will have qualitative aspects and that may be relevant when assessing the risks of material misstatement include disclosures about the following:*

- *Liquidity and debt covenants of an entity in financial distress*
- *Events or circumstances that have led to the recognition of an impairment loss*
- *Key sources of estimation uncertainty, including assumptions about the future*
- *The nature of a change in accounting policy, and other relevant disclosures required by the applicable financial reporting framework, when, for example, new financial reporting requirements are expected to have a significant impact on the financial position and financial performance of the entity*
- *Share-based payment arrangements, including information about how any amounts recognized were determined, and other relevant disclosures*
- *Related parties and related party transactions*
- *Sensitivity analysis, including the effects of changes in assumptions used in the entity's valuation techniques intended to enable users to understand the underlying measurement uncertainty of a recorded or disclosed amount*

#### *Considerations Specific to Smaller Entities*

*.A143 Disclosures in the financial statements of smaller entities may be less detailed or less complex (for example, some financial reporting frameworks allow smaller entities to provide fewer disclosures in the financial statements). However, this does not relieve the auditor of the responsibility to obtain an understanding of the entity and its environment, including internal control, as it relates to disclosures.*

[Paragraphs .A136–.A138 are renumbered as paragraphs .A144–.A146. The content is unchanged.]

***Material Misstatements (Ref: par. .27d)***

***.A147 Potential misstatements in individual statements and disclosures may be judged to be material due to size, nature, or circumstances.***

[Paragraphs .A139–.A157 are renumbered as paragraphs .A148–.A166. The content is unchanged.]

**Appendix C — Conditions and Events That May Indicate Risks of Material Misstatement (Ref: par. .A40A41 and .A135A140)**

***.A158A167***

The following are examples of conditions and events that may indicate the existence of risks of material misstatement *in the financial statements*. The examples provided cover a broad range of conditions and events; however, not all conditions and events are relevant to every audit engagement and the list of examples is not necessarily complete.

- Operations in regions that are economically unstable (for example, countries with significant currency devaluation or highly inflationary economies)
- Operations exposed to volatile markets (for example, futures trading)
- Operations that are subject to a high degree of complex regulation
- Going concern and liquidity issues, including loss of significant customers
- Constraints on the availability of capital and credit
- Changes in the industry in which the entity operates
- Changes in the supply chain
- Developing or offering new products or services or moving into new lines of business
- Expanding into new locations
- Changes in the entity, such as large acquisitions or reorganizations or other unusual events
- Entities or business segments likely to be sold
- The existence of complex alliances and joint ventures

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- Use of off balance sheet finance, investments in entities formed to accomplish specific objectives, and other complex financing arrangements
- Significant transactions with related parties
- Lack of personnel with appropriate accounting and financial reporting skills
- Changes in key personnel, including departure of key executives
- Deficiencies in internal control, especially those not addressed by management
- ***Incentives for management and employees to engage in fraudulent financial reporting***
- Inconsistencies between the entity's IT strategy and its business strategies
- Changes in the IT environment
- Installation of significant new IT systems related to financial reporting
- Inquiries into the entity's operations or financial results by regulatory or government bodies
- Past misstatements, history of errors, or a significant amount of adjustments at period-end
- Significant amount of nonroutine or nonsystematic transactions, including intercompany transactions and large revenue transactions at period-end
- Transactions that are recorded based on management's intent (for example, debt refinancing, assets to be sold, and classification of marketable securities)
- Application of new accounting pronouncements
- Accounting measurements that involve complex processes
- Events or transactions that involve significant measurement uncertainty, including accounting estimates, ***and related disclosures***
- ***Omitting, or obscuring, significant information in disclosures***
- Pending litigation and contingent liabilities (for example, sales warranties, financial guarantees, and environmental remediation)

## AU-C Section 320, *Materiality in Planning and Performing an Audit*

### Introduction

[No amendments to paragraphs .01–.05.]

### Materiality in the Context of an Audit

**.06** In planning the audit, the auditor makes judgments about the size of misstatements that will be considered material. These judgments provide a basis for

- a. determining the nature and extent of risk assessment procedures;
- b. identifying and assessing the risks of material misstatement; and
- c. determining the nature, timing, and extent of further audit procedures.

The materiality determined when planning the audit does not necessarily establish an amount below which uncorrected misstatements, individually or in the aggregate, will always be evaluated as immaterial. The circumstances related to some misstatements may cause the auditor to evaluate them as material even if they are below materiality. ~~Although it~~ <sup>It</sup> is not practicable to design audit procedures to detect *all* misstatements that could be material solely because of their nature (that is, qualitative considerations); *However, consideration of the nature of potential misstatements in disclosures is relevant to the design of audit procedures to address risks of material misstatement.*<sup>1</sup> *In addition, when evaluating the effect on the financial statements of all uncorrected misstatements,* the auditor considers not only the size but also the nature of uncorrected misstatements, and the particular circumstances of their occurrence, ~~when evaluating their effect on the financial statements.~~<sup>fn+2</sup> (Ref: par. .A1)

<sup>1</sup> See paragraphs .A141–.A142 of section 315, *Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement*.

<sup>fn+2</sup> [Footnote omitted for purposes of this SAS.]

[Footnote 2 is renumbered as footnote 3.]

[No amendments to paragraphs .07–.14.]

### Application and Other Explanatory Material

*Materiality in the Context of an Audit (Ref: par. .06)*

*.A1 Identifying and assessing the risks of material misstatement<sup>4</sup> involves the use of professional judgment to identify those classes of transactions, account balances, and disclosures, including qualitative disclosures, the misstatement of which could be material (in general, misstatements are considered to be material if they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements as a whole). When considering whether misstatements in qualitative disclosures could be material, the auditor may identify relevant factors such as the following:*

- *The circumstances of the entity for the period (For example, the entity may have undertaken a significant business combination during the period.)*
- *The applicable financial reporting framework, including changes therein (For example, a new financial reporting standard may require new qualitative disclosures that are significant to the entity.)*
- *Qualitative disclosures that are important to users of the financial statements because of the nature of an entity (For example, liquidity risk disclosures may be important to users of the financial statements for a financial institution.)*

*<sup>4</sup> Paragraph .26 of section 315 requires the auditor to identify and assess the risk of material misstatement at the financial statement and assertion levels.*

[All subsequent footnotes are renumbered.]

[Paragraphs .A1–.A11 are renumbered as .A2–.A12. The content is unchanged.]

## **Determining Materiality and Performance Materiality When Planning the Audit**

*Materiality Level or Levels for Particular Classes of Transactions, Account Balances, or Disclosures (Ref: par. .10)*

~~A12.A13~~ **A13** Factors that may indicate the existence of one or more particular classes of transactions, account balances, or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements include the following:

- Whether law, regulation, or the applicable financial reporting framework affect users' expectations regarding the measurement or disclosure of certain items (for example, related party transactions, ~~and~~ the remuneration of management and those charged with governance, **and sensitivity analysis for fair value accounting estimates with high estimation uncertainty**)
- The key disclosures with regard to the industry in which the entity operates (for example, research and development costs for a pharmaceutical company)
- Whether attention is focused on a particular aspect of the entity's business that is separately disclosed in the financial statements (for example, ~~a newly acquired~~

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~~business~~ *disclosures about discontinued operations or a significant business combination*)

[Paragraphs .A13–.A16 are renumbered as paragraphs .A14–.A17. The content is unchanged.]

**AU-C Section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained***

[No amendments to paragraphs .01–.20.]

*Substantive Procedures Related to the Financial Statement Closing Process*

**.21** The auditor’s substantive procedures should include audit procedures related to the financial statement closing process, such as

- a. agreeing or reconciling **information in** the financial statements with the underlying accounting records, **including agreeing or reconciling information in disclosures, whether such information is obtained from within or outside of the general and subsidiary ledgers**, and
- b. examining material journal entries and other adjustments made during the course of preparing the financial statements. (Ref: par. .A57)

[No amendments to paragraphs .22–.25.]

**Adequacy of Presentation and Disclosure** of the Financial Statements

**.26** The auditor should perform audit procedures to evaluate whether the overall presentation of the financial statements, ~~including the related disclosures~~, is in accordance with the applicable financial reporting framework. **In making this evaluation, the auditor should consider whether the financial statements are presented in a manner that reflects the following:**

- a. **The appropriate classification and description of financial information and the underlying transactions, events, and conditions**
- b. **The appropriate presentation, structure, and content of the financial statements (Ref: par. .A72)**

[No amendments to paragraphs .27–.32.]

**Documentation**

**.33** The auditor’s documentation should demonstrate that **information in** the financial statements agrees or reconciles with the underlying accounting records, **including agreeing or reconciling disclosures, whether such information is obtained from within or outside of the general and subsidiary ledgers.**

[No amendments to paragraphs .A1–.A13.]

*Responding to the Assessed Risks at the Assertion Level (Ref: par. .07a)*

**.A14** In addition, certain audit procedures can be performed only at or after the period-end, ~~For~~ example,

- agreeing *or reconciling information in* the financial statements, *including classes of transactions, account balances, and disclosures, with the underlying* ~~to the~~ accounting records *including, as applicable, those relevant accounting records that are outside the general and subsidiary ledgers;*
- examining adjustments made during the course of preparing the financial statements; and
- procedures to respond to a risk that at the period-end the entity may have entered into improper sales contracts or transactions may not have been finalized.

**.A15** Further relevant factors that influence the auditor’s consideration of when to perform audit procedures include

- the effectiveness of the control environment.
- when relevant information is available (for example, electronic files may subsequently be overwritten, or procedures to be observed may occur only at certain times).
- the nature of the risk (for example, if there is a risk of inflated revenues to meet earnings expectations by subsequent creation of false sales agreements, the auditor may examine contracts available on the date of the period-end).
- the period or date to which the audit evidence relates.
- *the timing of the preparation of the financial statements, particularly for those disclosures that provide further explanation about amounts recorded in the financial statements.*

[No amendments to paragraphs .A16–.A56.]

*Substantive Procedures Related to the Financial Statement Closing Process (Ref: par. .21b)*

**.A57** The nature and also the extent of the auditor's *substantive procedures related to the financial statement closing process, including* testing the appropriateness of journal entries and other adjustments, depends on the nature and complexity of the entity's financial reporting process and the related risks of material misstatement.

[No amendments to paragraphs .A58–.A71.]

**Adequacy of Presentation and Disclosure of the Financial Statements (Ref: par. .26)**

**.A72** Evaluating the ~~overall~~ *appropriate* presentation, *structure, and content* of the financial statements, ~~including the related disclosures, relates to whether the individual financial statements are presented in a manner that reflects the appropriate classification and description of financial information, and the form, arrangement, and content of the financial statements and their appended notes. This includes, for example,~~ *consideration of* the terminology used *as required by the applicable financial reporting framework*, the ~~amount~~ *level* of detail ~~given~~ *provided, the* classification of items in the statements, *aggregation and disaggregation of amounts*, and the bases of amounts set forth.

[No amendments to paragraphs .A73–.A76.]

**AU-C Section 450, *Evaluation of Misstatements Identified During the Audit***

[No amendments to paragraphs .01–.04.]

**Definitions**

**.04** For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

**Misstatement.** A difference between the *reported* amount, classification, presentation, or disclosure of a ~~reported~~ financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be presented fairly in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud. Misstatements also include those adjustments of amounts, classifications, presentations, or disclosures that, in the auditor’s professional judgment, are necessary for the financial statements to be presented fairly, in all material respects. (Ref: par. .A1)

...

[No amendments to paragraphs .05–.12.]

***Misstatement (Ref: par. .04)***

**.A1** Misstatements may result from fraud or error, such as

- a. an inaccuracy in gathering or processing data from which the financial statements are prepared;
- b. an omission of an amount or disclosure, *including inadequate or incomplete disclosures and omission of those disclosures required to meet disclosure objectives of certain financial reporting frameworks as applicable*;
- c. a financial statement disclosure that is not presented in accordance with the applicable financial reporting framework;
- d. an incorrect accounting estimate arising from overlooking, or clear misinterpretation of, facts; ~~and~~

- e. judgments of management concerning accounting estimates that the auditor considers unreasonable or the selection or application of accounting policies that the auditor considers inappropriate;
- f. *an inappropriate classification, aggregation, or disaggregation of information; and*
- g. *the omission of a disclosure necessary for the financial statements to achieve fair presentation beyond disclosures specifically required by the framework.*

Other examples of misstatements arising from fraud are provided in section 240, *Consideration of Fraud in a Financial Statement Audit*.<sup>5</sup>

<sup>5</sup> [Footnote omitted for purposes of this SAS.]

### **Accumulation of Identified Misstatements (Ref: par. .05)**

#### ***“Clearly Trivial”***

~~.A2 The auditor may designate an amount below which misstatements would be clearly trivial and would not need to be accumulated because the auditor expects that the accumulation of such amounts clearly would not have a material effect on the financial statements. Paragraph .05 requires the auditor to accumulate misstatements identified during the audit other than those that are clearly trivial. “Clearly trivial” is not another expression for “not material.” Matters~~ ***Misstatements*** that are clearly trivial will be of a wholly different (smaller) order of magnitude, ***or of a wholly different nature, than those that would be determined to be material*** ~~than materiality determined in accordance with section 320, and will be matters~~ ***and will be misstatements*** that are clearly inconsequential, whether taken individually or in the aggregate and whether judged by any criteria of size, nature, or circumstances. When there is any uncertainty about whether one or more items are clearly trivial, the ~~matter~~ ***misstatement*** is considered not to be clearly trivial.

#### ***Misstatements in Individual Statements***

***.A3 The auditor may designate an amount below which misstatements of amounts in the individual statements would be clearly trivial and would not need to be accumulated because the auditor expects that the accumulation of such amounts clearly would not have a material effect on the financial statements. However, misstatements of amounts that are above the designated amount would be accumulated as required by paragraph .05. In addition, misstatements relating to amounts may not be clearly trivial based on their nature or circumstances and, if not clearly trivial, would be accumulated as required by paragraph .05 of this section.***

#### ***Misstatements in Disclosures***

***.A4 Misstatements in disclosures may also be clearly trivial whether taken individually or in the aggregate and whether judged based on size, nature, or circumstances. Misstatements in disclosures that are not clearly trivial are also accumulated to assist the auditor in evaluating***

*the effect of such misstatements on the relevant disclosures and the financial statements as a whole. Paragraph .A23 provides examples of when misstatements in qualitative disclosures may be material.*

### *Accumulation of Misstatements*

*.A5 Misstatements by nature or circumstances, accumulated as described in paragraphs .A3–.A4, cannot be added together as is possible in the case of misstatements of amounts. Nevertheless, the auditor is required by paragraph .11 to evaluate those misstatements individually and in the aggregate (that is, collectively with other misstatements) to determine whether they are material.*

~~.A3~~**A6** To assist the auditor in evaluating the effect of misstatements accumulated during the audit and in communicating misstatements to management and those charged with governance, it may be useful to distinguish between factual misstatements, judgmental misstatements, and projected misstatements, described as follows:

- *Factual misstatements* are misstatements about which there is no doubt.
- *Judgmental misstatements* are differences arising from the judgments of management **including those** concerning **recognition, measurement, presentation, and disclosure in the financial statements (including accounting estimates that the auditor considers unreasonable, or the selection or application of accounting policies) that the auditor considers *unreasonable or* inappropriate.**
- *Projected misstatements* are the auditor’s best estimate of misstatements in populations, involving the projection of misstatements identified in audit samples to the entire population from which the samples were drawn. Guidance on the determination of projected misstatements and evaluation of the results is set out in section 530, *Audit Sampling*.<sup>6</sup>

<sup>6</sup>[Footnote omitted for purposes of this SAS.]

[Paragraphs .A4–.A5 are renumbered .A7–.A8. The content is unchanged.]

### **Communication and Correction of Misstatements (Ref: par. .07–.09)**

~~.A6~~**A9** Timely communication of misstatements to the appropriate level of management is important because it enables management to evaluate whether the ~~items~~ **classes of transactions, account balances, and disclosures** are misstatements, inform the auditor if it disagrees, and take action as necessary. Ordinarily, the appropriate level of management is the one that has responsibility and authority to evaluate the misstatements and to take the necessary action.

[Paragraphs .A7–.A18 are renumbered as .A10–.A21. The content is unchanged.]

### **Evaluating the Effect of Uncorrected Misstatements (Ref: par. .10–.11)**

~~.A19.~~**A22** Each individual misstatement *of an amount* is considered to evaluate its effect on the relevant classes of transactions, account balances, or disclosures, including whether the materiality level for that particular class of transactions, account balance, or disclosure, if any, has been exceeded.

**.A23** *In addition, each individual misstatement of a qualitative disclosure is considered to evaluate its effect on the relevant disclosures, as well as its overall effect on the financial statements as a whole. The determination of whether a misstatement in a qualitative disclosure is material, in the context of the applicable financial reporting framework and the specific circumstances of the entity, is a matter that involves the exercise of professional judgment. Examples of misstatements that may be material include the following:*

- *Inaccurate or incomplete descriptions of information about the objectives, policies, and processes for managing capital*
- *The omission of information about the events or circumstances that have led to an impairment loss (for example, a significant long-term decline in the demand for a metal or commodity)*
- *An incorrect description of an accounting policy relating to a significant item in any of the statements that the financial statements comprise*
- *An inadequate description of the sensitivity of an exchange rate*

**.A24** *In determining whether uncorrected misstatements by nature are material as required by paragraph .11, the auditor considers uncorrected misstatements in amounts and disclosures. Such misstatements may be considered material either individually or in combination with other misstatements. For example, depending on the misstatements identified in disclosures, the auditor may consider the following:*

- *Whether identified errors are recurring or pervasive*
- *Whether a number of identified misstatements are relevant to the same matter and, considered collectively, may affect the users' understanding of that matter*

*This consideration of accumulated misstatements is also helpful when evaluating the financial statements as discussed in paragraph .A15 of section 700, Forming an Opinion and Reporting on Financial Statements, of this SAS<sup>16</sup> or paragraph A70 of Statement on Auditing Standards Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans*

Subject to ERISA,<sup>17,‡</sup> *which states that evaluating whether the financial statements achieve fair presentation may include discussions with management about whether the presentation of amounts or disclosures obscures useful information or results in misleading information.*

<sup>16</sup> *Paragraph .16 of section 700, Forming an Opinion and Reporting on Financial Statements, of this SAS.*

<sup>17</sup> *Paragraph 41 of Statement on Auditing Standards Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA.*

[Footnote 16 is renumbered as footnote 18.]

[Paragraphs .A20–.A23 are renumbered as .A25–.A28. The content is unchanged.]

~~.A24.A29~~ Section 240 explains how the implications of a misstatement that is, or may be, the result of fraud are required to be considered with regard to other aspects of the audit, even if the size of the misstatement is not material in relation to the financial statements.<sup>‡+17</sup> <sup>19</sup> *Depending on the circumstances, misstatements in disclosures could also be indicative of fraud and, for example, may arise from the following:*

- *Misleading disclosures that have resulted from bias in management’s judgments*
- *Extensive duplicative or uninformative disclosures that are intended to obscure a proper understanding of matters in the financial statements*

*When considering the implications of misstatements in classes of transactions, account balances, and disclosures, the auditor exercises professional skepticism in accordance with section 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards.<sup>19</sup>*

<sup>19</sup> *Paragraph .17 of section 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards.*

[All subsequent footnotes are renumbered.]

[Paragraphs .A25–.A28 are renumbered as .A30–.A33. The content is unchanged.]

### **AU-C Section 510, Opening Balances — Initial Audit Engagements, Including Reaudit Engagements**

[No amendments to paragraphs .01–.A17.]

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<sup>‡</sup> These are anticipated paragraph references from SAS *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, which is expected to be issued as a final SAS in the first half of 2019.

## Audit Conclusions and Reporting

Opening Balances (Ref: par. .15)

*.A18 If the auditor encountered significant difficulty in obtaining sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements, the auditor may determine this to be a key audit matter in accordance with section 701, Communicating Key Audit Matters in the Independent Auditor's Report, of this SAS.*

[Paragraph .A18 is renumbered as paragraph .A19. The content is unchanged.]

## Exhibit A — Illustration of Report With Disclaimer of Opinion on Results of Operations and Cash Flows and Unmodified Opinion on Financial Statements

~~.A19~~ .A20 Circumstances include the following:

- *Audit of a complete set of general purpose financial statements. The audit is not a group audit.*
- *Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America, as promulgated by the Financial Accounting Standards Board.*
- *The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210, Terms of Engagement.*
- The auditor did not observe the counting of the physical inventory at the beginning of the current period and was unable to obtain sufficient appropriate audit evidence regarding the opening balances of inventory.
- The possible effects of the inability to obtain sufficient appropriate audit evidence regarding opening balances of inventory are deemed to be material and pervasive to the entity's results of operations and cash flows.<sup>1</sup>
- The financial position at year-end is fairly presented.
- A disclaimer of opinion regarding the results of operations and cash flows and an unmodified opinion regarding financial position is considered appropriate in the circumstances.
- *Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about*

*the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern.*

- *The auditor has not been engaged to communicate key audit matters.*

<sup>1</sup> [Footnote omitted for purposes of this SAS.]

## **Independent Auditor's Report**

[Appropriate Addressee]

Report on the *Audit of the* Financial Statements<sup>2</sup>

### ***Opinions***

We have audited the ~~accompanying~~ balance sheet of ABC Company as of December 31, 20X1, and were engaged to audit 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.

### ***Disclaimer of Opinion on the Results of Operations and Cash Flows***

***We do not express an opinion on the results of operations and cash flows of ABC Company for the year ended December 31, 20X1.*** Because of the significance of the matter described in the Basis for Disclaimer of Opinion on the Results of Operations and Cash Flows ***section of our report*** paragraph, however, we ***have not been*** ~~were not~~ able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the results of operations and cash flows for the year ended December 31, 20X1. ~~Accordingly, we do not express an opinion on the results of operations and cash flows for the year ended December 31, 20X1.~~

### ***Opinion on the Financial Position***

In our opinion, the balance sheet presents fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, in accordance with accounting principles generally accepted in the United States of America.

### ***Basis for Opinions***

We were not engaged as auditors of the Company until after December 31, 20X0, and, therefore, did not observe the counting of physical inventories at the beginning of the year. We were unable to satisfy ourselves by performing other auditing procedures concerning

<sup>2</sup> The subtitle "Report on the *Audit of the* Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

the inventory held at December 31, 20X0. Since opening inventories enter into the determination of net income and cash flows, we were unable to determine whether any adjustments might have been necessary in respect of the profit for the year reported in the income statement and the net cash flows from operating activities reported in the cash flow statement.

We conducted our audit of the balance sheet in accordance with auditing standards generally accepted in the United States of America. ***Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit.*** ~~Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the balance sheet is free from material misstatement.~~

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

***Responsibilities of Management's Responsibility*** for the Financial Statements

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, ***and for ; this includes*** the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditor's ~~***Responsibility***~~ ***Responsibilities for the Audit of the Financial Statements***

Our responsibility is to ***conduct an audit of the Company's*** ~~express an opinion on these financial statements based on conducting the audit~~ in accordance with auditing standards generally accepted in the United States of America. ***However, b***Because of the matters described in the ***Basis for Opinions section of our report, paragraph, however,*** we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the results of operations and cash flows.

~~An audit 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, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.<sup>fn-3</sup> Accordingly, we express no such opinion. An audit 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.~~

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

*Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with generally accepted auditing standards (GAAS) will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.*

*In performing an audit in accordance with GAAS, we:*

- *Exercise professional judgment and maintain professional skepticism throughout the audit.*
- *Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.*
- *Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control.<sup>3</sup> Accordingly, no such opinion is expressed.*

- *Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.*
- *Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company’s ability to continue as a going concern for a reasonable period of time.*

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

*<sup>3</sup> In circumstances in which the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, the auditor should omit the following: “but not for the purpose of expressing an opinion on the effectiveness of ABC Company’s internal control. Accordingly, no such opinion is expressed.”*

#### **Report on Other Legal and Regulatory Requirements**

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

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

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

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

~~*[Date of the auditor’s report]*~~

[No further amendments to AU-C section 510.]

#### **AU-C Section 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures**

[No amendments to paragraphs .01–.A17.]

#### ***Obtaining an Understanding of How Management Identifies the Need for Accounting Estimates (Ref: par. .08b)***

**.A18** Inquiries of management about changes in circumstances may include, for example, inquiries about whether

- the entity has engaged in new types of transactions that may give rise to accounting estimates.
- terms of transactions that gave rise to accounting estimates have changed.
- accounting policies relating to accounting estimates have changed as a result of changes to *within* the requirements of the applicable financial reporting framework or otherwise.
- regulatory or other changes outside the control of management have occurred that may require management to revise, or make new, accounting estimates.
- new conditions or events have occurred that may give rise to the need for new or revised accounting estimates.

[No amendments to paragraphs .A19–.A119. Paragraph .A119 included for context only.]

### **Recognition and Measurement Criteria**

*Recognition of the Accounting Estimates in the Financial Statements (Ref. par. .17a)*

**.A119** When management has recognized an accounting estimate in the financial statements, the focus of the auditor’s evaluation is on whether the measurement of the accounting estimate is sufficiently reliable to meet the recognition criteria of the applicable financial reporting framework.

**.A120** With respect to accounting estimates that have not been recognized, the focus of the auditor’s evaluation is on whether the recognition criteria of the applicable financial reporting framework have, in fact, been met. Even when an accounting estimate has not been recognized and the auditor concludes that this treatment is appropriate, there may be a need for disclosure of the circumstances in the notes to the financial statements. *When applicable, the auditor may also determine that **an accounting estimate that has been identified as having a high estimation uncertainty** there is a need to draw the reader’s attention to a significant uncertainty **is a key audit matter to be communicated in the auditor’s report in accordance with section 701, Communicating Key Audit Matters in the Independent Auditor’s Report, of this SAS or the auditor may consider it necessary to include** by adding an emphasis-of-matter paragraph to in the auditor’s report (see section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor’s Report, of this SAS*), addresses the use of such paragraphs. **If the matter is determined to be a key audit matter, section 706 of this SAS prohibits the auditor from including that matter in an emphasis-of-matter paragraph in the auditor’s report.***

[No further amendments to AU-C section 540.]

**AU-C Section 600, Special Considerations — Audits of Group Financial Statements  
(Including the Work of Component Auditors)**

[No amendments to paragraphs .01–.A96.]

## **Exhibit A — Illustrations of Auditor’s Reports on Group Financial Statements**

### **.A97**

Illustration 1 — A Report With a Qualified Opinion When the Group Engagement Team Is Not Able to Obtain Sufficient Appropriate Audit Evidence on Which to Base the Group Audit Opinion (Ref: par. .A27)

Illustration 2 — A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With Generally Accepted Auditing Standards (Ref: par. .A60)

Illustration 3 — A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using a Different Financial Reporting Framework Than That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With GAAS (Ref: par. .A60)

Illustration 4 — A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With Auditing Standards Other Than GAAS (Ref: par. .A60)

***Illustration 1 — A Report With a Qualified Opinion When the Group Engagement Team Is Not Able to Obtain Sufficient Appropriate Audit Evidence on Which to Base the Group Audit Opinion***

***Circumstances include the following:***

- ***Audit of a complete set of consolidated general purpose financial statements (comparative).***
- ***Management is responsible for the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.***
- ***The terms of the audit engagement reflect the description of management’s responsibility for the financial statements in section 210, Terms of Engagement.***
- ***The group engagement team is unable to obtain sufficient appropriate audit evidence relating to a significant component accounted for by the equity method because the***

*group engagement team was unable to obtain the audited financial statements of the component as of December 31, 20X1 and 20X0, including the auditor's report thereon. In this example, the auditor of the group financial statements is not making reference to the report of a component auditor. In the auditor's professional judgment, the effect on the group financial statements of this inability to obtain sufficient appropriate audit evidence is material but not pervasive. Accordingly, the auditor's report contains a qualified opinion.*

- *Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern.*
- *The auditor has not been engaged to communicate key audit matters.*

### *Independent Auditor's Report*

*[Appropriate Addressee]*

#### **Report on the Audit of the Consolidated Financial Statements<sup>1</sup>**

<sup>1</sup> *The subtitle "Report on the Audit of the Consolidated Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.*

#### **Qualified Opinion**

*We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.*

*In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion section of our report, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.*

#### **Basis for Qualified Opinion**

*We were unable to obtain audited financial statements supporting the Company's investment in a foreign affiliate stated at \$\_\_\_\_\_ and \$\_\_\_\_\_ at December 31, 20X1 and 20X0, respectively, or its equity in earnings of that affiliate of \$\_\_\_\_\_ and \$\_\_\_\_\_, which is included in net income for the years then ended as described in Note X to the consolidated financial statements; nor were we able to satisfy ourselves as to the carrying value of the investment in the foreign affiliate or the equity in its earnings by other auditing procedures.*

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

#### **Responsibilities of Management for the Financial Statements**

*Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.*

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

#### **Auditor's Responsibilities for the Audit of the Financial Statements**

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

*In performing an audit in accordance with GAAS, we:*

- *Exercise professional judgment and maintain professional skepticism throughout the audit.*
- *Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risk. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.*
- *Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>2</sup>*
- *Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.*
- *Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.*

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

<sup>2</sup> *In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, omit the following: “but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.”*

#### **Report on Other Legal and Regulatory Requirements**

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

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

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

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

**Illustration 1—A Report With a Qualified Opinion When the Group Engagement Team Is Not Able to Obtain Sufficient Appropriate Audit Evidence on Which to Base the Group Audit Opinion**

~~In this example, the group engagement team is unable to obtain sufficient appropriate audit evidence relating to a significant component accounted for by the equity method because the group engagement team was unable to obtain the audited financial statements of the component as of December 31, 20X1 and 20X0, including the auditor's report thereon. In this example, the auditor of the group financial statements is not making reference to the report of a component auditor.~~

~~In the auditor's professional judgment, the effect on the group financial statements of this inability to obtain sufficient appropriate audit evidence is material but not pervasive. If, in the auditor's professional judgment, the effect on the group financial statements of the inability to obtain sufficient appropriate audit evidence is material and pervasive, the auditor would disclaim an opinion, in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*.~~

### **Independent Auditor's Report**

~~[Appropriate Addressee]~~

#### **Report on the Consolidated Financial Statements<sup>fn1</sup>**

~~We have audited the accompanying consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.~~

#### ***Management's Responsibility for the Financial Statements***

~~Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.~~

#### ***Auditor's Responsibility***

~~Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally~~

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<sup>fn1</sup> The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

~~accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.~~

~~An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.<sup>fn2</sup> Accordingly, we express no such opinion. An audit 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 consolidated financial statements.~~

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

***Basis for Qualified Opinion***

~~We were unable to obtain audited financial statements supporting the Company's investment in a foreign affiliate stated at \$\_\_\_\_\_ and \$\_\_\_\_\_ at December 31, 20X1 and 20X0, respectively, or its equity in earnings of that affiliate of \$\_\_\_\_\_ and \$\_\_\_\_\_, which is included in net income for the years then ended as described in Note X to the consolidated financial statements; nor were we able to satisfy ourselves as to the carrying value of the investment in the foreign affiliate or the equity in its earnings by other auditing procedures.~~

***Qualified Opinion***

~~In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion paragraph, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ABC Company and its~~

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<sup>fn2</sup> In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances." In addition, the next sentence, "Accordingly, we express no such opinion." would not be included.

~~subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.~~

**~~Report on Other Legal and Regulatory Requirements~~**

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

~~[Auditor's signature]~~

~~[Auditor's city and state]~~

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

***Illustration 2 — A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With Generally Accepted Auditing Standards***

***Circumstances include the following:***

- ***Audit of a complete set of consolidated general purpose financial statements (comparative).***
- ***Management is responsible for the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.***
- ***The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210, Terms of Engagement.***
- ***The auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using the same financial reporting framework as that used for the group financial statements and performed by a component auditor in accordance with generally accepted auditing standards (GAAS).***
- ***The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.***
- ***Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in***

**accordance with section 570, The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern.**

- *The auditor has not been engaged to communicate key audit matters.*

**Independent Auditor’s Report**

**[Appropriate Addressee]**

**Report on the Audit of the Consolidated Financial Statements<sup>1</sup>**

<sup>1</sup> *The subtitle “Report on the Audit of the Consolidated Financial Statements” is unnecessary in circumstances in which the second subtitle, “Report on Other Legal and Regulatory Requirements,” is not applicable.*

**Opinion**

*We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders’ equity, and cash flows for the years then ended, and the related notes to the financial statements.*

*In our opinion, based on our audits and the report of the other auditors, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.*

*We did not audit the financial statements of B Company, a wholly owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of the other auditors.*

**Basis for Opinion**

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

## Responsibilities of Management for the Financial Statements

*Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.*

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

## Auditor's Responsibilities for the Audit of the Financial Statements

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

*In performing an audit in accordance with GAAS, we:*

- Exercise professional judgment and maintain professional skepticism throughout the audit.*
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.*
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>2</sup>*

- *Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.*
- *Conclude, whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company’s ability to continue as a going concern for a reasonable period of time.*

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

<sup>2</sup> *In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, omit the following: “but not for the purpose of expressing an opinion on the effectiveness of ABC Company’s internal control. Accordingly, no such opinion is expressed.”*

#### **Report on Other Legal and Regulatory Requirements**

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

*[Signature of auditor’s firm]*

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

*[Date of the auditor’s report]*

~~Illustration 2 — A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With Generally Accepted Auditing Standards~~

~~In this example, the auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using the same financial reporting framework as that used for the group financial statements and performed by a component auditor in accordance with generally accepted auditing standards (GAAS).~~

#### **Independent Auditor’s Report**

*{Appropriate Addressee}*

## **Report on the Consolidated Financial Statements<sup>fn1</sup>**

~~We have audited the accompanying consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.~~

### ***Management's Responsibility for the Financial Statements***

~~Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.~~

### ***Auditor's Responsibility***

~~Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of B Company, a wholly owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.~~

~~An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.<sup>fn2</sup> Accordingly, we express~~

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<sup>fn1</sup> ~~The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.~~

<sup>fn2</sup> ~~In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's~~

~~no such opinion. An audit 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 consolidated financial statements.~~

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

***Opinion***

~~In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.~~

**~~Report on Other Legal and Regulatory Requirements~~**

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

~~[Auditor's signature]~~

~~[Auditor's city and state]~~

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

***Illustration 3 — A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using a Different Financial Reporting Framework From That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With GAAS***

***Circumstances are the same as in illustration 2, except in this example, the auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using a different financial reporting framework than that used for the group financial statements and performed by a component auditor in accordance with GAAS.***

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~~preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances.” In addition, the next sentence, “Accordingly, we express no such opinion.” would not be included.~~

**Independent Auditor's Report**

*[Appropriate Addressee]*

**Report on the Audit of the Consolidated Financial Statements<sup>1</sup>**

<sup>1</sup> *The subtitle "Report on the Audit of the Consolidated Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.*

**Opinion**

*We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.*

*In our opinion, based on our audits and the report of the other auditors, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.*

*We did not audit the financial statements of B Company, a wholly owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements, which were prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, were audited by other auditors, whose report has been furnished to us. We have applied audit procedures on the conversion adjustments to the financial statements of B Company, which conform those financial statements to accounting principles generally accepted in the United States of America. Our opinion, insofar as it relates to the amounts included for B Company, prior to these conversion adjustments, is based solely on the report of the other auditors.*

**Basis for Opinion**

*We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in*

*accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.*

### **Responsibilities of Management for the Financial Statements**

*Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.*

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

### **Auditor's Responsibilities for the Audit of the Financial Statements**

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

*In performing an audit in accordance with GAAS, we:*

- *Exercise professional judgment and maintain professional skepticism throughout the audit.*
- *Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.*
- *Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>2</sup>*

- *Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.*
- *Conclude, whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company’s ability to continue as a going concern for a reasonable period of time.*

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

*<sup>2</sup>In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, omit the following: “but not for the purpose of expressing an opinion on the effectiveness of ABC Company’s internal control. Accordingly, no such opinion is expressed.”*

#### **Report on Other Legal and Regulatory Requirements**

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

*[Signature of auditor’s firm]*

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

*[Date of the auditor’s report]*

~~Illustration 3—A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using a Different Financial Reporting Framework From That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With GAAS~~

~~In this example, the auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using a different financial reporting framework than that used for the group financial statements and performed by a component auditor in accordance with GAAS.~~

#### **Independent Auditor’s Report**

*{Appropriate Addressee}*

## **Report on the Consolidated Financial Statements<sup>fn1</sup>**

We have audited the accompanying consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of B Company, a wholly-owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements, which were prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, were audited by other auditors, whose report has been furnished to us. We have applied audit procedures on the conversion adjustments to the financial statements of B Company, which conform those financial statements to accounting principles generally accepted in the United States of America. Our opinion, insofar as it relates to the amounts included for B Company, prior to these conversion adjustments, is based solely on the report of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of

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<sup>fn1</sup> The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

~~the consolidated 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 consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.<sup>fn2</sup> Accordingly, we express no such opinion. An audit 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 consolidated financial statements.~~

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

***Opinion***

~~In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.~~

**~~Report on Other Legal and Regulatory Requirements~~**

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

~~[Auditor's signature]~~

~~[Auditor's city and state]~~

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

***Illustration 4 — A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and***

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<sup>fn2</sup> In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances." In addition, the next sentence, "Accordingly, we express no such opinion." would not be included.

***Performed by a Component Auditor in Accordance With Auditing Standards Other Than GAAS***

*Circumstances are the same as in illustration 2, except in this example, the auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using the same financial reporting framework as that used for the group financial statements and performed by a component auditor in accordance with auditing standards other than GAAS or standards promulgated by the Public Company Accounting Oversight Board. The group engagement partner has determined that the component auditor performed additional audit procedures to meet the relevant requirements of GAAS. If additional procedures were not necessary for the audit of the component auditor to meet the relevant requirements of GAAS, illustration 2 is applicable.*

***Independent Auditor's Report***

**[Appropriate Addressee]**

**Report on the Audit of the Consolidated Financial Statements<sup>1</sup>**

<sup>1</sup> *The subtitle "Report on the Audit of the Consolidated Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.*

**Opinion**

*We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.*

*In our opinion, based on our audits and the report of, and additional audit procedures performed by, the other auditors, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.*

*We did not audit the financial statements of B Company, a wholly owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements were audited by other auditors in accordance with [describe the set of*

*auditing standards], whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of, and additional audit procedures to meet the relevant requirements of auditing standards generally accepted in the United States of America performed by, the other auditors.*

### **Basis for Opinion**

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

### **Responsibilities of Management for the Financial Statements**

*Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.*

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

### **Auditor's Responsibilities for the Audit of the Financial Statements**

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

*In performing an audit in accordance with GAAS, we:*

- *Exercise professional judgment and maintain professional skepticism throughout the audit.*
- *Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.*
- *Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company’s internal control. Accordingly, no such opinion is expressed.<sup>2</sup>*
- *Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.*
- *Conclude, whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company’s ability to continue as a going concern for a reasonable period of time.*

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

<sup>2</sup>*In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, omit the following: “but not for the purpose of expressing an opinion on the effectiveness of ABC Company’s internal control. Accordingly, no such opinion is expressed.”*

#### **Report on Other Legal and Regulatory Requirements**

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

**[Signature of auditor’s firm]**

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

**[Date of the auditor’s report]**

~~Illustration 4—A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same~~

~~Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With Auditing Standards Other Than GAAS~~

~~In this example, the auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using the same financial reporting framework as that used for the group financial statements and performed by a component auditor in accordance with auditing standards other than GAAS or standards promulgated by the Public Company Accounting Oversight Board. The group engagement partner has determined that the component auditor performed additional audit procedures to meet the relevant requirements of GAAS. If additional procedures were not necessary for the audit of the component auditor to meet the relevant requirements of GAAS, illustration 2 is applicable.~~

**Independent Auditor's Report**

*{Appropriate Addressee}*

**Report on the Consolidated Financial Statements<sup>fn+</sup>**

~~We have audited the accompanying consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.~~

***Management's Responsibility for the Financial Statements***

~~Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.~~

***Auditor's Responsibility***

~~Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of B Company, a wholly-owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements were audited by other auditors in~~

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<sup>fn+</sup> ~~The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.~~

~~accordance with [describe the set of auditing standards], whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of, and additional audit procedures to meet the relevant requirements of auditing standards generally accepted in the United States of America performed by, the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.~~

~~An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.<sup>fn2</sup> Accordingly, we express no such opinion. An audit 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 consolidated financial statements.~~

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

### ***Opinion***

~~In our opinion, based on our audits and the report of, and additional audit procedures performed by, the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.~~

### **Report on Other Legal and Regulatory Requirements**

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<sup>fn2</sup>~~In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances." In addition, the next sentence, "Accordingly, we express no such opinion." would not be included.~~

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

~~[Auditor's signature]~~

~~[Auditor's city and state]~~

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

[No further amendments to AU-C section 600.]

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

[No amendments to paragraphs .01–.A10.]

**Exhibit — Illustrations of Auditor's Reports on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country (Ref: par. .A7)**

**.A11**

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

**Independent Auditor's Report**

[Appropriate Addressee]

***Opinion***

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

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

***Basis for Opinion***

*We conducted our audit in accordance with auditing standards generally accepted in the United States of America (and [in name of country]). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit.*

***Management's ~~Responsibility~~ Responsibilities of Management for the Financial Statements***

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

**[Describe management's responsibilities for evaluating whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern, when the applicable financial reporting framework includes such a requirement.<sup>1</sup>]**

**<sup>1</sup>Paragraph .32b of section 700, Forming an Opinion and Reporting on Financial Statements, of this SAS.**

***Auditor's ~~Responsibility~~ Responsibilities for the Audit of the Financial Statements***

~~Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America (and [in name of country]).~~ ***Our objectives are*** Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements *as a whole* are free from material misstatement, ***whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with generally accepted auditing standards will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users made on the basis of these financial statements.***

*In performing an audit in accordance with GAAS, we:*

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

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

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

### ***Opinion***

~~In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, and the~~

~~results of its operations and its cash flows for the year then ended in accordance with [specify the financial reporting framework generally accepted] in [name of country].~~

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

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

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

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

### **Independent Auditor's Report**

*[Appropriate Addressee]*

#### ***Opinion***

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

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

#### ***Basis for Opinion***

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

*Emphasis of Matter*

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

~~*Management's Responsibility*~~ *Responsibilities of Management for the Financial Statements*

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

**[Describe management's responsibilities for evaluating whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern, when the applicable financial reporting framework includes such a requirement.<sup>1</sup>]**

<sup>1</sup> *Paragraph .32b of section 700, Forming an Opinion and Reporting on Financial Statements, of this SAS.*

~~*Auditor's Responsibility*~~ *Responsibilities for the Audit of the Financial Statements*

~~Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America (and [*in name of country*]). Our objectives are~~ Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements *as a whole* are free from material misstatement, *whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with generally accepted auditing standards will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users made on the basis of these financial statements.*

*In performing an audit in accordance with GAAS, we:*

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

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

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

### ***Opinion***

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

***Emphasis of Matter***

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

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

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

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

***Amendment to SAS No. 132, The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern***

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

**The amendment to each AU-C section is effective for audits of financial statements for periods ending on or after December 15, 2020. Early implementation is not permitted.**

***AU-C Section 570, The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern***

[No amendments to paragraphs .01–.23].

*Use of the Going Concern Basis of Accounting Is Appropriate But Conditions and Events Have Been Identified*

**.24** If, after considering identified conditions or events and management's plans, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains, the auditor should include ~~an emphasis of matter paragraph~~ ***a separate section*** in the auditor's report:<sup>6</sup> ***with the heading "Substantial Doubt About the Entity's Ability to Continue as a Going Concern" that does the following:*** (Ref: par. .A51–.A57A58)

- a. *Draws attention to the note in the financial statements that discloses***
  - i. the conditions or events identified and management's plans that deal with these conditions or events and***
  - ii. that these conditions or events indicate that substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time***
- b. *States that the auditor's opinion is not modified with respect to the matter***

<sup>6</sup> ~~Paragraphs .06–.07 of AU-C section 706, *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report* (AICPA, *Professional Standards*), address requirements concerning emphasis of matter paragraphs.~~

**.25** *The description in the “Going Concern” section* about the entity’s ability to continue as a going concern for a reasonable period of time should be expressed through the use of *use* terms consistent with those included in the applicable financial reporting framework. ~~In a going concern emphasis-of-matter paragraph, the~~ *The* auditor should not use conditional language concerning the existence of substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time.

*Adequate Disclosure About an Entity’s Ability to Continue as a Going Concern Is Not Made in the Financial Statements*

**.26** If adequate disclosure about an entity’s ability to continue as a going concern for a reasonable period of time is not made in the financial statements, the auditor should ***do the following:***

**a.** *Express a qualified opinion or adverse opinion, as appropriate, in accordance with section 705, Modifications to the Opinion in the Independent Auditor’s Report, of this SAS.*

**b.** *In the “Basis for Qualified (Adverse) Opinion” section of the auditor’s report, state that*

- i. substantial doubt exists about the entity’s ability to continue as a going concern and that the financial statements do not adequately disclose this matter or*
- ii. substantial doubt about the entity’s ability to continue as a going concern has been alleviated by management’s plans but the financial statements do not adequately disclose this matter.*

[No amendments to paragraphs .27–.28. Footnotes 7–38 are renumbered as 6–37.]

**Comparative Presentations**

**.29** If substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time existed at the date of prior period financial statements that are presented on a comparative basis and that doubt has been removed in the current period, the going concern ~~emphasis-of-matter paragraph~~ ***section*** included in the auditor’s report on the financial statements of the prior period should not be repeated. (Ref: par. ~~A59–A60~~ ***A60–A61***)

**Eliminating a “Going Concern” ~~Emphasis-of-Matter Paragraph~~ Section From a Reissued Report**

**.30** Management may request that the auditor reissue an auditor’s report and eliminate a “~~G~~***going Ce***oncern” ~~emphasis-of-matter paragraph~~ ***section*** contained therein. Although an auditor has no obligation to reissue the report, if the auditor decides to reissue the report, the auditor should reassess the going concern status of the entity by doing the following:

- a.** Performing audit procedures related to the events or transactions that prompted the request to reissue the report without the “~~G~~***going Ce***oncern” ~~emphasis-of-matter~~

~~paragraph~~ *section*

- b. Performing the procedures listed in section 560, *Subsequent Events and Subsequently Discovered Facts*, at or near the date of reissuance, including procedures to evaluate the adequacy of the proposed disclosures regarding management's plans to mitigate the conditions or events that raised substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time<sup>8 7</sup>
- c. Considering the matters described in paragraphs .16–.18 of this section based on the conditions or circumstances at the date of reissuance
- d. Considering the implications for the auditor's report in accordance with section 560<sup>9</sup>  
<sup>8</sup> (Ref: par. ~~A61–A62–A63~~)

<sup>8 7</sup> Paragraphs .09–.11 of section 560, *Subsequent Events and Subsequently Discovered Facts*.

<sup>9 8</sup> Paragraph .13 of section 560.

[No amendments to paragraphs .31–.A50.]

**Use of the Going Concern Basis of Accounting Is Appropriate But Conditions and Events Have Been Identified (Ref. par. .24–.26)**

*Conditions and Events Have Been Identified and Substantial Doubt Has Not Been Alleviated*

***.A51 The identification of substantial doubt is a matter that is important to users' understanding of the financial statements. The use of a separate section with a heading that includes reference to the fact that substantial doubt exists about the entity's ability to continue as going concern alerts users to this circumstance.***

***.A52 The appendix to this section provides an illustration of the statements that are required to be included in the auditor's report on the financial statements (illustration 1 ) and an illustration of the circumstances described in paragraph .A54 (illustration 2). Illustrations 1 and 2 provide examples in which FASB ASC is the applicable financial reporting framework. If an applicable financial reporting framework other than FASB ASC is used, the wording in the illustrative reports in the appendix to this section may need to be adapted to reflect the application of the other financial reporting framework in the circumstances.*** The following is an illustration of a going concern emphasis of matter paragraph when (a) the auditor concludes substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time, (b) management's plans do not alleviate the substantial doubt, and (c) the entity is required under the applicable financial reporting framework to include a statement in the notes to the financial statements that substantial doubt exists.

***Emphasis of Matter Regarding Going Concern***

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

~~modified with respect to this matter.~~

~~.A53 The following is an illustration of a going concern emphasis-of-matter paragraph when (a) the auditor concludes that substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time, (b) management's plans do not alleviate the substantial doubt, and (c) the entity is not required under the applicable financial reporting framework to include a statement in the notes to the financial statements that substantial doubt exists.~~

**Emphasis-of-Matter *Regarding Going Concern***

~~The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency that raise substantial doubt about its ability to continue as a going concern. Management's evaluation of the events and conditions and management's plans regarding these matters are also described in Note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.~~

~~.A51 .A53~~ When FASB ASC or the GASB statements are the applicable financial reporting framework used in the preparation of the financial statements, the auditor's conclusion about the entity's ability to continue as a going concern is expressed through the use of the phrase "substantial doubt about its (the entity's) ability to continue as a going concern." In other financial reporting frameworks, a similar term may be appropriate depending on the requirements of the applicable financial reporting framework. If the applicable financial reporting framework does not include comparable terms, then wording that includes the terms *substantial doubt* and *going concern* may be appropriate.

*Conditions and Events Have Been Identified and Substantial Doubt Has Been Alleviated*

~~.A54~~ If conditions or events, considered in the aggregate, have been identified that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time but, based on the audit evidence obtained, the auditor concludes that substantial doubt has been alleviated by management's plans ***and adequate disclosure has been made in the financial statements***, the auditor may include an emphasis-of-matter paragraph in accordance with ***section 706, AU-C section 706, Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report, of this SAS*** making reference to management's disclosures related to the conditions and events and management's plans related to those conditions and events.<sup>38 37</sup> ***In this circumstance, the use of an emphasis-of-matter paragraph is to draw users' attention to the disclosures of the conditions and events and management's plans. It is distinguished from the situation in which the auditor concludes, after considering identified conditions or events and management's plans, that substantial doubt about the entity's ability to continue as a going concern remains, in which case the auditor is required by paragraph .24 of this section to include a separate "Going Concern" section in the auditor's report.***

<sup>3837</sup> Paragraphs ~~.06–.07.08–.09~~ of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report, of this SAS*.

~~.A55 The following is an illustration of an emphasis-of-matter paragraph when management has disclosed (a) conditions or events, considered in the aggregate, that raised substantial doubt about~~

~~the entity's ability to continue as a going concern for a reasonable period of time; (b) its evaluation of the significance of those conditions or events, considered in the aggregate, in relation to the entity's ability to meet its obligations; and (c) that the substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time has been alleviated by management's plans.~~

~~As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency. Management's evaluation of the events and conditions and management's plans to mitigate these matters are also described in Note X. Our opinion is not modified with respect to this matter.~~

*As indicated in section 706 of this SAS, the use of an emphasis-of-matter paragraph is not appropriate if either of the following applies:*

- a. *The matter has been determined to be a key audit matter when section 701, Communicating Key Audit Matters in the Independent Auditor's Report, of this SAS applies.*
- b. *The auditor would be required to modify the opinion in accordance with section 705<sup>38</sup> of this SAS as a result of the matter.*

<sup>38</sup> *Paragraph .08 of section 706 of this SAS.*

~~.A56~~ *As indicated in section 705 of this SAS, in circumstances in which conditions and events have been identified and the auditor concludes that, based on the audit evidence obtained, the disclosures are materially misstated, the auditor is required to modify the auditor's report.<sup>39</sup>*

<sup>39</sup> *Paragraph .07 of section 705, Modifications to the Opinion in the Independent Auditor's Report, of this SAS.*

*Inappropriate Use of Conditional Language*

~~.A56~~ *.A57* Examples of conditional language that are inappropriate to use in the ~~emphasis-of-matter paragraph~~ **"Going Concern" section** include the following:

- a. If the Company continues to suffer recurring losses from operations and continues to have a net capital deficiency, there may be substantial doubt about its ability to continue as a going concern.
- b. The Company has been unable to renegotiate its expiring credit agreements. Unless the Company is able to obtain financial support, there is substantial doubt about its ability to continue as a going concern.

[Paragraphs .A57–.A60 are renumbered as .A58–.A61. The content is unchanged.]

**Eliminating a Going Concern ~~Emphasis-of-Matter Paragraph~~ Section From a Reissued Report (Ref: par. .30)**

~~.A61~~ *.A62* After the auditor has issued the auditor's report containing a ~~"Ggoing Ceoncern"~~ **"Going Concern" emphasis-of-matter paragraph section**, the auditor may be asked to reissue the auditor's report on the financial statements and eliminate the ~~"Ggoing Ceoncern"~~ **"Going Concern" emphasis-of-matter paragraph**

## *Amendments*

***section*** that appeared in the original report. Such requests may occur after the conditions or events that gave rise to substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time have been resolved. For example, subsequent to the date of the auditor's original report, an entity might obtain needed financing.

[Paragraphs .A62–.A63 are renumbered as .A63–.A64. Footnotes 39–40 are renumbered as 40–41. The content is unchanged.]

*Exhibit — Illustrations of Auditor’s Reports Relating to Going Concern (Ref: par. .A52–.A56)*

*.A65*

***Illustration 1 — An Auditor’s Report Containing an Unmodified Opinion and Includes a Going Concern Section When Management Is Required Under the Applicable Financial Reporting Framework to Include a Statement In the Notes to the Financial Statements That Conditions or Events Have Been Identified and Substantial Doubt Exists and Disclosure In The Financial Statements Is Adequate***

***Illustration 2 — An Auditor’s Report Containing an Unmodified Opinion and Includes an Emphasis-of-Matter Paragraph Because Substantial Doubt Has Been Alleviated***

***Illustration 1 — An Auditor’s Report Containing an Unmodified Opinion and Includes a Going Concern Section When Management Is Required Under the Applicable Financial Reporting Framework to Include a Statement In the Notes to the Financial Statements That Conditions or Events Have Been Identified and Substantial Doubt Exists and Disclosure In The Financial Statements Is Adequate***

***For purposes of this illustrative auditor’s report, the following circumstances are assumed:***

- ***Audit of a complete set of financial statements prepared in accordance with FASB ASC. The audit is not a group audit.***
- ***The auditor has concluded that an unmodified opinion is appropriate based on the audit evidence obtained.***
- ***The auditor has concluded, after considering identified conditions or events and management’s plans, that substantial doubt remains and the disclosures of the conditions or events and management’s plans are adequate.***
- ***Management is required under FASB ASC to include an explicit statement in the notes to the financial statements that conditions or events have been identified and substantial doubt exists.***

**Independent Auditor’s Report**

***To the Shareholders of ABC Company [or Other Appropriate Addressee]***

**Report on the Audit of the Financial Statements**

***The auditor’s report is presented in accordance with paragraphs .21–.42 of section 700, Forming an Opinion and Reporting on Financial Statements, of this SAS. For illustrative***

*purposes, the Going Concern section is presented immediately after the “Basis for Opinion of the Auditor’s Report” section.*

### **Substantial Doubt About the Company’s Ability to Continue as a Going Concern**

*The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations, has a net capital deficiency, and has stated that substantial doubt exists about the Company’s ability to continue as a going concern. Management’s evaluation of the events and conditions and management’s plans regarding these matters are also described in Note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.*

*Illustration 2 — An Auditor’s Report Containing an Unmodified Opinion and Includes an Emphasis-of-Matter Paragraph Because Substantial Doubt Has Been Alleviated (see .A52)*

*For purposes of the illustrative auditor’s report, the following circumstances are assumed:*

- *Audit of a complete set of financial statements prepared in accordance with FASB ASC. The audit is not a group audit.*
- *Management has disclosed conditions or events, considered in the aggregate, that raised substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time.*
- *Management has disclosed its evaluation of the significance of those conditions or events, considered in the aggregate, in relation to the entity’s ability to meet its obligations.*
- *Management has disclosed that the substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time has been alleviated by management’s plans.*
- *The auditor has concluded that management’s disclosures are adequate.*

### **Independent Auditor’s Report**

*To the Shareholders of ABC Company [or Other Appropriate Addressee]*

### **Report on the Audit of the Financial Statements**

*The auditor’s report is presented in accordance with paragraph .09 of section 706, Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor’s Report,*

*Amendments*

*of this SAS.*

*Emphasis-of-Matter*

***As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency. Management's evaluation of the events and conditions and management's plans to mitigate these matters are also described in Note X. Our opinion is not modified with respect to this matter.***

## **AU-C Section 701**

### ***Communicating Key Audit Matters in the Independent Auditor's Report***

#### **Introduction**

#### **Scope of This Section**

**.01** This section addresses the auditor's responsibility to communicate key audit matters in the auditor's report when the auditor is engaged to do so. It is intended to address both the auditor's judgment about what to communicate in the auditor's report and the form and content of such communication. This section does not require the communication of key audit matters. (Ref: par. .A1)

**.02** The purpose of communicating key audit matters is to provide greater transparency about the audit that was performed. The communication of key audit matters in the auditor's report may also provide intended users of the financial statements (intended users) with a basis to further engage with management and those charged with governance about certain matters relating to the entity, the audited financial statements, or the audit that was performed. (Ref: par. .A2–.A3)

**.03** Communicating key audit matters in the auditor's report is done in the context of the auditor having formed an opinion on the financial statements as a whole. Communicating key audit matters in the auditor's report does *not* constitute the following:

- a. A substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make or that are otherwise necessary to achieve fair presentation
- b. A substitute for the auditor expressing a modified opinion when required to do so by the circumstances of a specific audit engagement in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*, of this Statement on Auditing Standards (SAS)
- c. A substitute for reporting in accordance with AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*,\* if, after considering identified conditions or events and management's plans, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains
- d. A separate opinion on individual matters (Ref: par. .A4–.A6)

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

**.04** This section applies to an audit of a complete set of general purpose financial statements when the auditor is engaged to communicate key audit matters. Section 705 of this SAS prohibits the auditor from communicating key audit matters when the auditor expresses an adverse opinion or disclaims an opinion on the financial statements, unless such reporting is required by law or regulation.<sup>1</sup>

### **Effective Date**

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

### **Objectives**

**.06** The objectives of the auditor are to determine key audit matters and communicate those matters by describing them in the auditor's report.

### **Definition**

**.07** For purposes of generally accepted auditing standards (GAAS), the following term has the meaning attributed as follows:

**Key audit matters.** Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.

### **Requirements**

#### **Determining Key Audit Matters**

**.08** The auditor should determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor should take into account the following: (Ref: par. .A7–.A16)

- a.* Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (Ref: par. .A17–.A20)
- b.* Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty (Ref: par. .A21–.A22)

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<sup>1</sup> Paragraph .30 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*, of this Statement on Auditing Standards (SAS).

- c. The effect on the audit of significant events or transactions that occurred during the period (Ref: par. .A23–.A24)

**.09** The auditor should determine which of the matters determined in accordance with paragraph .08 were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters. (Ref: par. .A7–.A9, .A25–.A30)

### **Communicating Key Audit Matters**

**.10** The auditor should describe each key audit matter, using an appropriate subheading, in a separate section of the auditor's report under the heading "Key Audit Matters," unless the circumstances in paragraphs .13 or .14 apply. The introductory language in this section of the auditor's report should state the following:

- a. Key audit matters are those matters that were communicated with those charged with governance and, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period.
- b. These matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, and the auditor does not provide a separate opinion on these matters. (Ref: par. .A31–.A33)

### ***Key Audit Matters Not a Substitute for Expressing a Modified Opinion***

**.11** The auditor should not communicate a matter in the "Key Audit Matters" section of the auditor's report when the auditor would be required to modify the opinion in accordance with section 705 of this SAS as a result of the matter. (Ref: par. .A4)

### ***Descriptions of Individual Key Audit Matters***

**.12** The description of each key audit matter in the "Key Audit Matters" section of the auditor's report should include a reference to the related disclosures, if any, in the financial statements and should address the following: (Ref: par. .A34–.A41)

- a. Why the matter was considered to be one of most significance in the audit and therefore determined to be a key audit matter (Ref: par. .A42–.A44)
- b. How the matter was addressed in the audit (Ref: par. .A45–.A50)

### ***Circumstances in Which a Matter Determined to Be a Key Audit Matter Is Not Communicated in the Auditor's Report***

**.13** The auditor should describe each key audit matter in the auditor's report unless either of the following applies:

- a. Law or regulation precludes disclosure about the matter. (Ref: par. .A51)

- b.* In extremely rare circumstances, the auditor determines that the matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication. This does not apply if information about the matter is available outside the entity. (Ref: par. .A52–.A55)

***Interaction Between Descriptions of Key Audit Matters and Other Elements Required to Be Included in the Auditor's Report***

**.14** Matters giving rise to a qualified opinion in accordance with section 705 of this SAS, or when substantial doubt exists about an entity's ability to continue as a going concern for a reasonable period of time in accordance with AU-C section 570, are by their nature key audit matters. However, these matters should not be described in the "Key Audit Matters" section of the auditor's report, and the requirements in paragraphs .12–.13 do not apply. Rather, the auditor should do the following:

- a.* Report on these matters in accordance with the applicable AU-C sections.
- b.* Include a reference to the "Basis for Qualified Opinion" or "Going Concern" section in the "Key Audit Matters" section. (Ref: par. .A5)

***Form and Content of the "Key Audit Matters" Section in Other Circumstances***

**.15** If the auditor determines, depending on the facts and circumstances of the entity and the audit, that there are no key audit matters to communicate or that the only key audit matters communicated are those matters addressed by paragraph .14, the auditor should include a statement to this effect in a separate section of the auditor's report under the heading "Key Audit Matters." (Ref: par. .A56–.A57)

**Communication With Those Charged With Governance**

- .16** The auditor should communicate the following with those charged with governance:
- a.* Those matters the auditor has determined to be the key audit matters, or
  - b.* If applicable, depending on the facts and circumstances of the entity and the audit, the auditor's determination that there are no key audit matters to communicate in the auditor's report (Ref: par. .A58–.A61)

**Documentation**

**.17** The auditor should include the following in the audit documentation:<sup>2</sup> (Ref: par. .A62)

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<sup>2</sup> Paragraphs .08–.12 and .A8 of AU-C section 230, *Audit Documentation*.

- a. The matters that required significant auditor attention as determined in accordance with paragraph .08, and the rationale for the auditor's determination about whether or not each of the matters is a key audit matter in accordance with paragraph .09
- b. When applicable, the rationale for the auditor's determination that there are no key audit matters to communicate in the auditor's report or that the only key audit matters to communicate are those matters addressed by paragraph .14
- c. When applicable, the rationale for the auditor's determination not to communicate in the auditor's report a matter determined to be a key audit matter

## **Application and Other Explanatory Material**

### **Scope of This Section (Ref: par. .01–.02)**

**.A1** Paragraph .45 and related application material in section 700, *Forming an Opinion and Reporting on Financial Statements*, of this SAS address reporting on audits conducted in accordance with the standards of the PCAOB and GAAS when the audit is not within the jurisdiction of the PCAOB.

**.A2** Communicating key audit matters provides additional information to intended users to assist them in understanding those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Communicating key audit matters may also assist intended users in understanding the entity and areas of significant management judgment in the audited financial statements.

**.A3** AU-C section 320, *Materiality in Planning and Performing an Audit*, explains that it is reasonable for the auditor to assume the following regarding users of the financial statements:<sup>3</sup>

- a. Users have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence.
- b. Users understand that the financial statements are prepared, presented, and audited to levels of materiality.
- c. Users recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment, and the consideration of future events.
- d. Users make reasonable economic decisions on the basis of the information in the financial statements.

Because the auditor's report accompanies the audited financial statements, the users of the auditor's report are considered to be the same as the intended users of the financial statements.

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<sup>3</sup> Paragraph .04 of AU-C section 320, *Materiality in Planning and Performing an Audit*.

***Relationship Between Key Audit Matters, the Auditor's Opinion, and Other Elements of the Auditor's Report (Ref: par. .03, .11, .14)***

**.A4** Section 700 of this SAS and SAS *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*<sup>†</sup> establish requirements and provide guidance on forming an opinion on the financial statements.<sup>4</sup> Communicating key audit matters is not a substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make or that are otherwise necessary to achieve fair presentation. Section 705 of this SAS addresses circumstances in which the auditor concludes that there is a material misstatement relating to the appropriateness or adequacy of disclosures in the financial statements.<sup>5</sup>

**.A5** When the auditor expresses a qualified opinion in accordance with section 705 of this SAS, communicating key audit matters would still be relevant to enhancing intended users' understanding of the audit. In these circumstances, presenting the description of the matter giving rise to a qualified opinion in the "Basis for Qualified Opinion" section gives the matter the appropriate prominence in the auditor's report (see paragraph .14) and separates the communication of this matter from any other key audit matters described in the "Key Audit Matters" section. The exhibit in section 705 of this SAS includes illustrative examples of how the introductory language in the "Key Audit Matters" section is affected when the auditor expresses a qualified opinion and other key audit matters are communicated in the auditor's report. Paragraph .A57 of this section illustrates how the "Key Audit Matters" section is presented when the auditor has determined that there are no other key audit matters to be communicated in the auditor's report beyond matters addressed in the "Basis for Qualified Opinion" or "Going Concern" sections of the auditor's report.

**.A6** Section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*, of this SAS establishes mechanisms for auditors of financial statements of all entities to include additional communication in the auditor's report through the use of emphasis-of-matter paragraphs and other-matter paragraphs when the auditor considers it necessary to do so. However, when section 701 of this SAS applies, the use of an emphasis-of-matter or other-matter paragraph is not a substitute for including a matter in the "Key Audit Matters" section of the auditor's report if the matter meets the definition of a key audit matter. Section 706 of this SAS provides further guidance on the relationship between key audit matters and emphasis-of-matter and other-matter paragraphs.<sup>6</sup>

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<sup>†</sup> SAS *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA* is expected to be issued as a final SAS in the second half of 2019.

<sup>4</sup> Paragraphs .12–.17 and .A5–.A20 of section 700, *Forming an Opinion and Reporting on Financial Statements*, of this SAS and paragraphs 37–42 and A61–A74 of SAS *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*. These are anticipated paragraph references from SAS *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, which is expected to be issued as a final SAS in the second half of 2019.

<sup>5</sup> Paragraph .A7 of section 705 of this SAS.

<sup>6</sup> Paragraphs .A1–.A2 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*, of this SAS.

**Determining Key Audit Matters (Ref: par. .08–.09)**

**.A7** The auditor's decision-making process in determining key audit matters begins with selecting, from among the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit of the financial statements of the current period.

**.A8** From the matters that required significant auditor attention, the auditor then determines those matters that, in the auditor's judgment, were of most significance in the audit of the financial statements of the current period and that, therefore, are the key audit matters. The auditor's determination of key audit matters is limited to those matters of most significance in the audit of the financial statements of the current period, even when comparative financial statements are presented (that is, even when the auditor's opinion refers to each period for which financial statements are presented).

**.A9** This section does not require the auditor to update key audit matters included in the prior period's auditor's report. However, it may nevertheless be useful for the auditor to consider whether a matter that was a key audit matter in the audit of the financial statements of the prior period continues to be a key audit matter in the audit of the financial statements of the current period.

***Matters That Required Significant Auditor Attention (Ref: par. .08)***

**.A10** The concept of significant auditor attention recognizes that an audit is risk based and focuses on identifying and assessing the risks of material misstatement of the financial statements, designing and performing audit procedures responsive to those risks, and obtaining audit evidence that is sufficient and appropriate to provide a basis for the auditor's opinion. For a particular account balance, class of transactions or disclosure, the higher an assessed risk of material misstatement at the assertion level, the more judgment is often involved in planning and performing the audit procedures and evaluating the results thereof.

**.A11** Accordingly, matters that pose challenges to the auditor in obtaining sufficient appropriate audit evidence or pose challenges to the auditor in forming an opinion on the financial statements may be particularly relevant in the auditor's determination of key audit matters.

**.A12** Areas of significant auditor attention often relate to areas of complexity and significant management judgment in the financial statements and therefore often involve difficult or complex auditor judgments. In turn, this often affects the auditor's overall audit strategy, the allocation of resources, and the extent of audit effort in relation to such matters. These effects may include, for example, the extent of involvement of senior personnel on the audit engagement or the involvement of an auditor's specialist or individuals with expertise in a specialized area of accounting or auditing, whether engaged or employed by the firm to address these areas.

**.A13** Certain AU-C sections, such as the following, require specific communications with those charged with governance and others that may relate to areas of significant auditor attention:

- a. AU-C section 260, *The Auditor's Communication With Those Charged With Governance*, requires the auditor to communicate significant difficulties, if any, encountered during the audit with those charged with governance.<sup>7</sup> For example, there may be potential difficulties relating to the following:
- i. *Related party transactions*. In particular, there may be limitations on the auditor's ability to obtain audit evidence that all other aspects of a related party transaction (other than price) are equivalent to those of a similar arm's-length transaction.<sup>8</sup>
  - ii. *Limitations on the group audit*. For example, the group engagement team's access to information may be restricted.<sup>9</sup>
- b. AU-C section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, establishes requirements for the engagement partner in relation to undertaking appropriate consultation on difficult or contentious matters.<sup>10</sup> For example, the auditor may have consulted with others within the firm or outside the firm on a significant technical matter, which may be an indicator that it is a key audit matter. The engagement partner is also required to discuss, among other things, significant matters arising during the audit engagement with the engagement quality control reviewer.

***Considerations in Determining Those Matters That Required Significant Auditor Attention (Ref: par. .08)***

**.A14** The auditor may develop a preliminary view at the planning stage about matters that are likely to be areas of significant auditor attention in the audit and therefore may be key audit matters. The auditor may communicate this with those charged with governance when discussing the planned scope and timing of the audit in accordance with AU-C section 260. However, the auditor's determination of key audit matters is based on the results of the audit or evidence obtained throughout the audit.

**.A15** Paragraph .08 includes specific required considerations in the auditor's determination of those matters that required significant auditor attention. These considerations focus on the nature of matters communicated with those charged with governance that are often linked to matters disclosed in the financial statements and are intended to reflect areas of the audit of the financial statements that may be of particular interest to intended users. The fact that these considerations are required is not intended to imply that matters related to them are always key audit matters; rather, matters related to such specific considerations are key audit matters only if they are

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<sup>7</sup> Paragraphs .12b and .A26 of AU-C section 260, *The Auditor's Communication With Those Charged With Governance*.

<sup>8</sup> Paragraph .A46 of AU-C section 550, *Related Parties*.

<sup>9</sup> Paragraph .49d of AU-C section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*.

<sup>10</sup> Paragraph .20 of AU-C section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

determined to be of most significance in the audit in accordance with paragraph .09. Because the considerations may be interrelated (for example, matters relating to the circumstances described in paragraphs .08b–c may also be identified as significant risks), the applicability of more than one of the considerations to a particular matter communicated with those charged with governance may increase the likelihood of the auditor identifying that matter as a key audit matter.

**.A16** In addition to matters that relate to the specific required considerations in paragraph .08, there may be other matters communicated with those charged with governance that required significant auditor attention and that therefore may be determined to be key audit matters in accordance with paragraph .09. Such matters may include, for example, matters that are relevant to the audit that was performed but that may not be required to be disclosed in the financial statements. For example, the implementation of a new IT system (or significant changes to an existing IT system) during the period may be an area of significant auditor attention, particularly if such a change had a significant effect on the auditor's overall audit strategy or related to a significant risk (for example, changes to a system affecting revenue recognition).

*Areas of Higher Assessed Risk of Material Misstatement, or Significant Risks Identified in Accordance With AU-C Section 315 (Ref: par. .08a)*

**.A17** AU-C section 260 requires the auditor to communicate with those charged with governance about the significant risks identified by the auditor.<sup>11</sup> AU-C section 260 explains that the auditor may also communicate with those charged with governance about areas of higher assessed risks of material misstatement.<sup>12</sup>

**.A18** AU-C section 315 defines a *significant risk* as an identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration. Areas of significant management judgment and significant unusual transactions may often be identified as significant risks. Significant risks are therefore often areas that require significant auditor attention.

**.A19** However, this may not be the case for all significant risks. For example, AU-C section 240, *Consideration of Fraud in a Financial Statement Audit*, presumes that there are risks of fraud in revenue recognition and requires the auditor to treat those assessed risks of material misstatement due to fraud as significant risks.<sup>13</sup> In addition, AU-C section 240 indicates that, due to the unpredictable way in which management override of controls could occur, it is a risk of material misstatement due to fraud and thus a significant risk.<sup>14</sup> Depending on their nature, these risks may not require significant auditor attention and therefore would not be considered in the auditor's determination of key audit matters in accordance with paragraph .09.

**.A20** AU-C section 315 explains that the auditor's assessment of the risks of material misstatement at the assertion level may change during the course of the audit as additional audit

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<sup>11</sup> Paragraph .11 of AU-C section 260.

<sup>12</sup> Paragraph .A20 of AU-C section 260.

<sup>13</sup> Paragraphs .26–.27 of AU-C section 240, *Consideration of Fraud in a Financial Statement Audit*.

<sup>14</sup> Paragraph .31 of AU-C section 240.

evidence is obtained.<sup>15</sup> Revision to the auditor's risk assessment and reevaluation of the planned audit procedures with respect to a particular area of the financial statements may result in an area being determined to be one requiring significant auditor attention, particularly when the revision results in a higher assessed risk of material misstatement. For example, the auditor's risk assessment may have been based on an expectation that certain controls were operating effectively, but the audit evidence obtained may indicate that such controls were not operating effectively throughout the audit period, leading to a change in audit strategy and additional audit effort.

*Significant Auditor Judgments Relating to Areas in the Financial Statements That Involved Significant Management Judgment, Including Accounting Estimates That Have Been Identified as Having High Estimation Uncertainty (Ref: par. .08b)*

**.A21** AU-C section 260 requires the auditor to communicate with those charged with governance the auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates, and financial statement disclosures.<sup>16</sup> In particular, this may include accounting policies that have a significant effect on the financial statements (and significant changes to those policies), especially in circumstances in which an entity's accounting policies are not consistent with others in its industry.

**.A22** In many cases, the auditor's communication with those charged with governance relates to accounting estimates and related disclosures. Among other things, estimates may be highly dependent on management judgment and are often the most complex areas of the financial statements, and the estimates may require the involvement of both a management's specialist and an auditor's specialist. Such estimates are often areas of significant auditor attention, and they may be identified as significant risks.

*The Effect on the Audit of Significant Events or Transactions That Occurred During the Period (Ref: par. .08c)*

**.A23** Events or transactions that had a significant effect on the financial statements or the audit may be areas of significant auditor attention and may be identified as significant risks. For example, the auditor may have had extensive discussions with management and those charged with governance at various stages throughout the audit about the effect on the financial statements of significant transactions with related parties or significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual.<sup>17</sup> Management may have made difficult or complex judgments in relation to recognition, measurement, presentation, or disclosure of such transactions, which may have had a significant effect on the auditor's overall strategy.

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<sup>15</sup> Paragraph .32 of AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

<sup>16</sup> Paragraph .12a of AU-C section 260.

<sup>17</sup> Paragraphs .12a, .14, and .A32 of AU-C section 260, and the appendix "Qualitative Aspects of Accounting Practices" of AU-C section 260.

**.A24** Significant economic, accounting, regulatory, industry, or other developments that affected management's assumptions or judgments may also affect the auditor's overall approach to the audit and result in a matter requiring significant auditor attention.

***Matters of Most Significance (Ref: par. .09)***

**.A25** The concept of matters of most significance is applicable in the context of the entity and the audit that was performed. As such, the intent is for the auditor to identify matters specific to the audit and to make a judgment about their relative importance.

**.A26** Matters that required significant auditor attention also may have resulted in significant interaction with those charged with governance. The nature and extent of communication about such matters with those charged with governance often provides an indication of which matters are of most significance in the audit. For example, the auditor may have had more in-depth, frequent, or robust interactions with those charged with governance on more difficult and complex matters, such as the application of significant accounting policies that were the subject of significant auditor or management judgment.

**.A27** The importance of a matter to intended users' understanding of the financial statements as a whole and, in particular, the matter's materiality to the financial statements is relevant to determining whether the matter is a key audit matter.

**.A28** Other considerations that may be relevant to determining the relative significance of a matter and whether such a matter is a key audit matter include the following:

- The nature of the underlying accounting policy relating to the matter or the complexity or subjectivity involved in management's selection of an appropriate policy compared to other entities within its industry
- The nature and materiality, quantitative or qualitative, of corrected and accumulated uncorrected misstatements due to fraud or error related to the matter, if any
- The nature and extent of audit effort needed to address the matter, including the following:
  - The extent of specialized skill or knowledge needed to apply audit procedures to address the matter or evaluate the results of those procedures, if any
  - The nature of consultations outside the engagement team regarding the matter
- The nature and severity of difficulties in applying audit procedures, evaluating the results of those procedures, and obtaining relevant and reliable evidence on which to base the auditor's opinion, particularly as the auditor's judgments become more subjective
- The severity of any control deficiencies identified that are relevant to the matter

- Whether the matter involved a number of separate, but related, auditing considerations (For example, long-term contracts may involve significant auditor attention with respect to revenue recognition, litigation, or other contingencies and may have an effect on other accounting estimates.)

**.A29** Determining which, and how many, of those matters that required significant auditor attention were of most significance in the audit of the financial statements of the current period is a matter of professional judgment. The number of key audit matters to be included in the auditor's report may be affected by the size and complexity of the entity, the nature of its business and environment, and the facts and circumstances of the audit engagement. In general, the greater the number of matters initially determined to be key audit matters, the more the auditor may need to reconsider whether each of these matters meets the definition of a key audit matter. Lengthy lists of key audit matters may be contrary to the notion of such matters being those of most significance in the audit.

**.A30** Paragraph .15 addresses the form and content of the "Key Audit Matters" section of the auditor's report when the auditor determines that there are no key audit matters to be communicated.

### **Communicating Key Audit Matters**

#### ***Separate "Key Audit Matters" Section in the Auditor's Report (Ref: par. .10)***

**.A31** Placing the separate "Key Audit Matters" section in close proximity to the "Opinion" and "Basis for Opinion" sections may give prominence to such information.

**.A32** The order of presentation of individual matters within the "Key Audit Matters" section is a matter of professional judgment. For example, such information may be organized in order of relative importance, may be based on the auditor's judgment, or may correspond to the manner in which matters are disclosed in the financial statements. The requirement in paragraph .10 to include subheadings is intended to further differentiate the matters.

**.A33** When comparative financial information is presented, the introductory language of the "Key Audit Matters" section is tailored to draw attention to the fact that the key audit matters described relate to only the audit of the financial statements of the current period and may include reference to the specific period covered by those financial statements (for example, "for the year ended December 31, 20X1").

#### ***Descriptions of Individual Key Audit Matters (Ref: par. .12)***

**.A34** The adequacy of the description of a key audit matter is a matter of professional judgment. The description of a key audit matter is meant to provide a succinct and balanced explanation to enable intended users to understand why the matter was one of most significance in the audit and how the matter was addressed in the audit. Limiting the use of highly technical auditing terms also helps enable intended users, who may not have a reasonable knowledge of auditing, to understand the basis for the auditor's focus on particular matters during the audit. The nature and extent of information provided by the auditor is intended to be balanced in the context of the responsibilities

of the respective parties (that is, for the auditor to provide useful information in a concise and understandable form while not inappropriately being the provider of original information about the entity).

**.A35** Original information is any information about the entity that has not otherwise been made publicly available by the entity (for example, the information has not been included in the financial statements or other information available at the date of the auditor's report and has not been addressed in other oral or written communications by management or those charged with governance). Such information is the responsibility of the entity's management and those charged with governance.

**.A36** Although the auditor seeks to avoid providing original information about the entity, it may be necessary for the auditor to do so in the description of a key audit matter. Such information may be necessary to appropriately explain why the matter was considered to be one of most significance in the audit, and therefore determined to be a key audit matter, and how the matter was addressed in the audit, provided that disclosure of such information is not precluded by law or regulation. When the auditor determines that it is necessary to include such information in the description of a key audit matter, management may elect to expand or supplement the entity's disclosures, rather than having the auditor provide original information in the auditor's report.

**.A37** Management or those charged with governance may decide to include new or enhanced disclosures in the financial statements or elsewhere in the annual report relating to a key audit matter in light of the fact that the matter will be communicated in the auditor's report. Such new or enhanced disclosures, for example, may be included to provide more robust information about the sensitivity of key assumptions used in accounting estimates or the entity's rationale for a particular accounting practice or policy when acceptable alternatives exist under the applicable financial reporting framework. Additional disclosures by management may also be helpful when the auditor considers it necessary to include additional information to explain why a matter was determined to be a key audit matter and how the matter was addressed in the audit.

**.A38** Although the auditor's opinion on the financial statements does not extend to the other information addressed by AU-C section 720, *Other Information in Documents Containing Audited Financial Statements*, the auditor may consider this information, as well as other publicly available communications by the entity or other credible sources, in formulating the description of a key audit matter.

**.A39** Audit documentation prepared during the audit can also be useful to the auditor in formulating the description of a key audit matter. For example, written communications, or the auditor's documentation of oral communications, with those charged with governance and other audit documentation provide a useful basis for the auditor's communication in the auditor's report. This is because audit documentation in accordance with AU-C section 230, *Audit Documentation*, is intended to address the significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions, and serves as a record of the nature, timing, and extent of the audit procedures performed, the results of those procedures, and the audit evidence obtained. Such documentation may assist the auditor in developing a description of key audit matters that explains the significance of the matters and may also assist in applying the requirement in paragraph .17.

*Reference to Where the Matter Is Disclosed in the Financial Statements (Ref: par. .12)*

**.A40** Paragraph .12 requires the description of each key audit matter to address why the auditor considered the matter to be one of most significance in the audit and how the matter was addressed in the audit. Accordingly, the description of key audit matters is not a mere reiteration of what is disclosed in the financial statements. However, a reference to any related disclosures enables intended users to further understand how management has addressed the matter in preparing the financial statements.

**.A41** In addition to referring to related disclosures, the auditor may draw attention to key aspects of them. The extent of disclosure by management about specific aspects or factors in relation to how a particular matter is affecting the financial statements of the current period may help the auditor pinpoint particular aspects of how the matter was addressed in the audit such that intended users can understand why the matter is a key audit matter, such as in the following examples:

- When an entity includes robust disclosure about accounting estimates, the auditor may draw attention to the disclosure of key assumptions, the disclosure of the range of possible outcomes, and other qualitative and quantitative disclosures relating to key sources of estimation uncertainty or critical accounting estimates as part of addressing why the matter was one of most significance in the audit and how the matter was addressed in the audit.
- When the auditor concludes, in accordance with AU-C section 570, that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time has been alleviated by management's plans, the auditor may nevertheless determine that one or more matters relating to this conclusion arising from the auditor's work effort under AU-C section 570 are key audit matters. In such circumstances, the auditor's description of such key audit matters in the auditor's report could include aspects of the identified events or conditions disclosed in the financial statements, such as substantial operating losses, available borrowing facilities and possible debt refinancing, or noncompliance with loan agreements, and related mitigating factors.<sup>18</sup>

*Why the Auditor Considered the Matter to Be One of Most Significance in the Audit (Ref: par. .12a)*

**.A42** The description of a key audit matter in the auditor's report is intended to provide insight regarding why the matter was determined to be a key audit matter. Accordingly, the requirements in paragraphs .08–.09 and the application material in paragraphs .A10–.A28 related to determining key audit matters may also be helpful for the auditor in considering how such matters are to be communicated in the auditor's report. For example, explaining the factors that led the auditor to conclude that a particular matter required significant auditor attention and was of most significance in the audit is likely to be of interest to intended users.

**.A43** Relating a matter directly to the specific circumstances of the entity may also help minimize the potential that such descriptions become overly standardized and less useful over time. For example, certain matters may be determined to be key audit matters in a particular

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<sup>18</sup> AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.

industry across a number of entities due to the circumstances of the industry or the underlying complexity in financial reporting. In describing why the auditor considered a matter to be one of most significance, it may be useful for the auditor to highlight aspects of the matter that are specific to the entity (for example, circumstances that affected the underlying judgments made in the financial statements of the current period) in order to make the description more relevant for intended users. This may also be important in describing a key audit matter that recurs over periods.

**.A44** The description may also make reference to the principal considerations that led the auditor, in the circumstances of the audit, to determine the matter to be one of most significance. The following are examples of such considerations:

- Economic conditions that affected the auditor's ability to obtain audit evidence, for example, illiquid markets for certain financial instruments
- New or emerging accounting policies, for example, entity-specific or industry-specific matters on which the engagement team consulted
- Changes in the entity's strategy or business model that had a material effect on the financial statements

*How the Matter Was Addressed in the Audit (Ref: par. .12b)*

**.A45** The amount of detail to be provided in the auditor's report to describe how a key audit matter was addressed in the audit is a matter of professional judgment. In accordance with paragraph .12b, the auditor may describe the following elements, or some combination thereof:

- Aspects of the auditor's response or approach that were most relevant to the matter or specific to the assessed risk of material misstatement
- A brief overview of procedures performed
- An indication of the outcome of the auditor's procedures
- Key observations with respect to the matter

Law or regulation may prescribe a specific form or content for the description of a key audit matter or may specify the inclusion of one or more of these elements.

**.A46** In order for intended users to understand the significance of a key audit matter in the context of the audit of the financial statements as a whole, as well as the relationship between key audit matters and other elements of the auditor's report, including the auditor's opinion, care may be necessary so that language used in the description of a key audit matter does the following:

- Does not imply that the matter has not been appropriately resolved by the auditor in forming the opinion on the financial statements

- Relates the matter directly to the specific circumstances of the entity, while avoiding generic or standardized language
- Takes into account how the matter is addressed in the related disclosures in the financial statements, if any
- Does not contain or imply discrete opinions on separate elements of the financial statements

**.A47** Describing aspects of the auditor's response or approach to a matter, particularly when the audit approach required significant tailoring to the facts and circumstances of the entity, may assist intended users in understanding unusual circumstances and significant auditor judgments required to address the risk of material misstatement. In addition, the audit approach in a particular period may have been influenced by entity-specific circumstances, economic conditions, or industry developments. It may also be useful for the auditor to make reference to the nature and extent of communications with those charged with governance about the matter.

**.A48** For example, in describing the auditor's approach to an accounting estimate that has been identified as having high estimation uncertainty, such as the valuation of complex financial instruments, the auditor may wish to highlight that the auditor employed or engaged an auditor's specialist. Such a reference to the use of an auditor's specialist does not reduce the auditor's responsibility for the opinion on the financial statements and is therefore not inconsistent with paragraphs .14–.15 of AU-C section 620, *Using the Work of an Auditor's Specialist*.

**.A49** There may be challenges in describing the auditor's procedures, particularly in complex, judgmental areas of the audit. In particular, it may be difficult to summarize the procedures performed in a succinct way that adequately communicates the nature and extent of the auditor's response to the assessed risk of material misstatement and the significant auditor judgments involved. Nonetheless, the auditor may consider it necessary to describe certain procedures that were performed to explain how a matter was addressed in the audit. Such description may typically be at a high level, rather than a detailed description of all procedures performed regarding the matter; that is, the auditor may describe just those procedures that are most relevant to the unique facts and circumstances of the entity and the current period audit.

**.A50** As noted in paragraph .A45, the auditor may also provide an indication of the outcome of the auditor's response in the description of the key audit matter in the auditor's report. However, if this is done, care is needed to avoid the auditor giving the impression that the description is conveying a separate opinion on an individual key audit matter or that the description in any way may call into question the auditor's opinion on the financial statements as a whole.

***Circumstances in Which a Matter Determined to Be a Key Audit Matter Is Not Communicated in the Auditor's Report (Ref: par. .13)***

**.A51** Law or regulation may preclude disclosure by either management or the auditor about a specific matter determined to be a key audit matter. For example, disclosure about a matter related to a government contractor may be precluded due to the nature of the matter and security clearance provisions that may apply to the auditor.

**.A52** As indicated by paragraph .13*b*, it will be extremely rare for a matter determined to be a key audit matter not to be communicated in the auditor's report. This is because there is presumed to be a public interest benefit in providing greater transparency about the audit for intended users. Accordingly, the judgment not to communicate a key audit matter is appropriate only in cases in which the adverse consequences to the entity or the public as a result of such communication are viewed as so significant that they would reasonably be expected to outweigh the public interest benefits of communicating the matter.

**.A53** The determination not to communicate a key audit matter takes into account the facts and circumstances related to the matter. Communication with management and those charged with governance helps the auditor understand management's views about the significance of the adverse consequences that may arise as a result of communicating a matter. In particular, communication with management and those charged with governance helps inform the auditor's judgment in determining whether to communicate the matter in the following ways:

- Assisting the auditor in understanding why the matter has not been disclosed by the entity (for example, if law, regulation, or certain financial reporting frameworks permit delayed disclosure or nondisclosure of the matter) and understanding management's views regarding the adverse consequences, if any, of disclosure. Management may draw attention to certain aspects in law or regulation or other authoritative sources that may be relevant to the consideration of adverse consequences (for example, such consequences may include harm to the entity's commercial negotiations or competitive position). However, management's views about the adverse consequences alone do not alleviate the need for the auditor to determine whether the adverse consequences would reasonably be expected to outweigh the public interest benefits of communication in accordance with paragraph .13*b*.
- Highlighting whether there have been any communications with applicable regulatory, enforcement, or supervisory authorities in relation to the matter and, in particular, whether such discussions would appear to support management's assertion about why public disclosure about the matter is not appropriate.
- Enabling the auditor, when appropriate, to encourage management and those charged with governance to disclose relevant information about the matter. In particular, this may be possible if the concerns of management and those charged with governance about communicating the matter are limited to specific aspects of the matter, such that certain information about the matter may be less sensitive and could be communicated.

The auditor also may consider it necessary to obtain a written representation from management explaining why disclosure of the matter is not appropriate, including management's view about the significance of the adverse consequences that may arise as a result of such communication.

**.A54** It may also be necessary for the auditor to consider the implications of communicating about a matter determined to be a key audit matter in light of relevant ethical requirements. In addition, the auditor may be required by law or regulation to communicate with applicable regulatory, enforcement, or supervisory authorities in relation to the matter, regardless of whether the matter is communicated in the auditor's report. Such communication may also help inform the

auditor's consideration of the adverse consequences that may arise from communicating about the matter.

**.A55** The issues considered by the auditor regarding a decision to not communicate a matter are complex and involve significant auditor judgment. Accordingly, the auditor may consider it appropriate to obtain legal advice.

***Form and Content of the "Key Audit Matters" Section in Other Circumstances (Ref: par. .15)***

**.A56** The requirement in paragraph .15 applies in three circumstances:

- In the rare circumstance that the auditor determines, in accordance with paragraph .09, that there are no key audit matters. This may be the case because there were no matters that required significant auditor attention.
- The auditor determines, in accordance with paragraph .13, that a key audit matter will not be communicated in the auditor's report and no other matters have been determined to be key audit matters.
- The only matters determined to be key audit matters are those communicated in accordance with paragraph .14.

**.A57** The following illustrates the presentation in the auditor's report if the auditor has determined there are no key audit matters to communicate:

**Key Audit Matters**

*[Except for the matter described in the Basis for Qualified Opinion section or Going Concern section,] We have determined that there are no [other] key audit matters to communicate in our report.*

**Communication With Those Charged With Governance (Ref: par. .16)**

**.A58** AU-C section 260 requires the auditor to communicate with those charged with governance on a timely basis. The appropriate timing for communications with those charged with governance about key audit matters will vary with the circumstances of the engagement. However, the auditor may communicate preliminary views about key audit matters when discussing the planned scope and timing of the audit and may further discuss such matters when communicating about audit findings. Doing so may help to alleviate the practical challenges of attempting to have a robust two-way dialogue about key audit matters at the time the financial statements are being finalized for issuance.

**.A59** Communication with those charged with governance enables them to be made aware of the key audit matters that the auditor intends to communicate in the auditor's report and provides them with an opportunity to obtain further clarification when necessary. The auditor may consider it useful to provide those charged with governance with a draft of the auditor's report to facilitate this discussion. Communication with those charged with governance recognizes their important

role in overseeing the financial reporting process and provides them the opportunity to understand the basis for the auditor's decisions in relation to key audit matters and how these matters will be described in the auditor's report. It also enables those charged with governance to consider whether new or enhanced disclosures may be useful in light of the fact that these matters will be communicated in the auditor's report.

**.A60** The communication with those charged with governance required by paragraph .16a also addresses the extremely rare circumstances in which a matter determined to be a key audit matter is not communicated in the auditor's report (see paragraphs .13 and .A53).

**.A61** The requirement in paragraph .16b to communicate with those charged with governance when the auditor has determined that there are no key audit matters to communicate in the auditor's report may provide an opportunity for the auditor to have further discussion with others who are familiar with the audit and the significant matters that may have arisen (including the engagement quality control reviewer, when one has been appointed). These discussions may cause the auditor to reevaluate the auditor's determination that there are no key audit matters.

#### **Documentation (Ref: par. .17)**

**.A62** Paragraph .08 of AU-C section 230 requires the auditor to prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand, among other things, significant professional judgments. In the context of key audit matters, these professional judgments include the determination, from the matters communicated with those charged with governance, of the matters that required significant auditor attention and whether or not each of those matters is a key audit matter. The auditor's judgments in this regard are likely to be supported by the documentation of the auditor's communications with those charged with governance and the audit documentation relating to each individual matter (see paragraph .A39), as well as by certain other audit documentation of the significant matters arising during the audit (for example, a completion memorandum). However, this section does not require the auditor to document why other matters communicated with those charged with governance were not matters that required significant auditor attention.

## **AU-C Section 705**

# ***Modifications to the Opinion in the Independent Auditor's Report***

### **Introduction**

#### **Scope of This Section**

**.01** This section addresses the auditor's responsibility to issue an appropriate report in circumstances in which, in forming an opinion in accordance with section 700, *Forming an Opinion and Reporting on Financial Statements*, of this Statement on Auditing Standards (SAS) or SAS *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*,\* the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary. This section also deals with how the form and content of the auditor's report is affected when the auditor expresses a modified opinion. In all cases, the reporting requirements in section 700 of this SAS or SAS *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA* apply; those requirements are not repeated in this section unless they are explicitly addressed or amended by the requirements of this section.

#### **Types of Modified Opinions**

**.02** This section establishes three types of modified opinions, namely, a qualified opinion, an adverse opinion, and a disclaimer of opinion. The decision regarding which type of modified opinion is appropriate depends on the following:

- a. The nature of the matter giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated
- b. The auditor's judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements (Ref: par. .A1)

**.03** Section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*, of this SAS and section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, of this SAS address additional communications in the auditor's report that are not modifications to the auditor's opinion.

#### **Effective Date**

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

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\* Statement on Auditing Standard (SAS) *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA* is expected to be issued as a final SAS in the second half of 2019.

## **Objective**

**.05** The objective of the auditor is to express clearly an appropriately modified opinion on the financial statements that is necessary in the following circumstances:

- a.* The auditor concludes, based on the audit evidence obtained, that the financial statements as a whole are materially misstated.
- b.* The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

## **Definitions**

**.06** For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

**Modified opinion.** A qualified opinion, an adverse opinion, or a disclaimer of opinion on the financial statements.

**Pervasive.** A term used, in the context of misstatements, to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate audit evidence. Pervasive effects on the financial statements are those that, in the auditor's judgment,

- are not confined to specific elements, accounts, or items of the financial statements;
- if so confined, represent or could represent a substantial proportion of the financial statements; or
- regarding disclosures, are fundamental to users' understanding of the financial statements.

## **Requirements**

### **Circumstances in Which a Modification to the Auditor's Opinion Is Required**

**.07** The auditor should modify the opinion in the auditor's report when

- a.* the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are materially misstated or (Ref: par..A2–.A8)
- b.* the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement. (Ref: par. .A9–.A13)

### **Determining the Type of Modification to the Auditor's Opinion**

### ***Qualified Opinion***

- .08** The auditor should express a qualified opinion in the following circumstances:
- a. The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material but not pervasive to the financial statements.
  - b. The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

### ***Adverse Opinion***

**.09** The auditor should express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

### ***Disclaimer of Opinion***

**.10** The auditor should disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive. (Ref. par. .A14–.A15)

### ***Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management-Imposed Limitation After the Auditor Has Accepted the Engagement***

**.11** If, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor should request that management remove the limitation.

**.12** If management refuses to remove the limitation referred to in paragraph .11, the auditor should communicate the matter to those charged with governance, unless all of those charged with governance are involved in managing the entity,<sup>1</sup> and, if appropriate, determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence.

**.13** If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor should determine the implications as follows:

- a. If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor should qualify the opinion.

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<sup>1</sup> Paragraph .09 of AU-C section 260, *The Auditor's Communication With Those Charged With Governance*. All AU-C sections can be found in AICPA *Professional Standards*.

- b. If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the severity of the situation, the auditor should
- i. disclaim an opinion on the financial statements or
  - ii. withdraw from the audit, when practicable. (Ref: par. .A16–.A17)

**.14** If the auditor decides to withdraw from the audit in accordance with paragraph .13bii, before doing so, the auditor should communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion. (Ref: par. .A17)

#### ***Other Considerations Relating to an Adverse Opinion or Disclaimer of Opinion***

**.15** When the auditor considers it necessary to express an adverse opinion or disclaim an opinion on the financial statements as a whole, the auditor's report should not also include an unmodified opinion with respect to the same financial reporting framework on a single financial statement or one or more specific elements, accounts, or items of a financial statement (piecemeal opinion). To include such an unmodified opinion in the same report<sup>2</sup> in these circumstances would contradict the auditor's adverse opinion or disclaimer of opinion on the financial statements as a whole. (Ref: par. .A18–.A19)

#### ***Auditor Is Not Independent But Is Required by Law or Regulation to Report on the Financial Statements***

**.16** When the auditor is not independent but is required by law or regulation to report on the financial statements, the auditor should disclaim an opinion and should specifically state that the auditor is not independent. The auditor is neither required to provide, nor precluded from providing, the reasons for the lack of independence; however, if the auditor chooses to provide the reasons for the lack of independence, the auditor should include all the reasons therefor. (Ref: par. .A20)

#### **Form and Content of the Auditor's Report When the Opinion Is Modified**

##### ***Auditor's Opinion***

**.17** When the auditor modifies the audit opinion, the auditor should use the heading "Qualified Opinion," "Adverse Opinion," or "Disclaimer of Opinion," as appropriate, for the "Opinion" section. (Ref: par. .A21–.A23)

##### ***Qualified Opinion***

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<sup>2</sup> AU-C section 805, *Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*, addresses special considerations relevant to an audit of a single financial statement or of a specific element, account, or item of a financial statement.

**.18** When the auditor expresses a qualified opinion due to a material misstatement in the financial statements, the auditor should state that, in the auditor's opinion, except for the effects of the matters described in the "Basis for Qualified Opinion" section of the auditor's report, the accompanying financial statements present fairly, in all material respects, [...] in accordance with [*the applicable financial reporting framework*]. When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor should use the corresponding phrase "except for the possible effects of the matters..." for the modified opinion. (Ref: par. .A24-.A25)

#### *Adverse Opinion*

**.19** When the auditor expresses an adverse opinion, the auditor should state that, in the auditor's opinion, because of the significance of the matters described in the "Basis for Adverse Opinion" section of the auditor's report, the accompanying financial statements do not present fairly [...] in accordance with [*the applicable financial reporting framework*].

#### *Disclaimer of Opinion*

**.20** When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor should do the following:

- a. State that the auditor does not express an opinion on the accompanying financial statements.
- b. State that, because of the significance of the matters described in the "Basis for Disclaimer of Opinion" section of the auditor's report, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements.
- c. Amend the statement required by paragraph .25b of section 700 of this SAS, or paragraph 64b of SAS *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*,<sup>†</sup> as applicable, which indicates that the financial statements have been audited, to state that the auditor was engaged to audit the financial statements.

#### *Basis for Opinion*

**.21** When the auditor modifies the opinion on the financial statements, the auditor should, in addition to including the specific elements required by section 700 of this SAS or SAS *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, do the following: (Ref: par. .A26)

- a. Amend the heading "Basis for Opinion" required by paragraph .28 of section 700 of this SAS, or paragraphs 67 or 107 of SAS *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable, to "Basis for

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<sup>†</sup> These paragraph references from SAS *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, and other paragraph references from that SAS that appear within this section, are anticipated paragraph references.

*Modification to the Opinion in the Independent Auditor's Report*

Qualified Opinion,” “Basis for Adverse Opinion,” or “Basis for Disclaimer of Opinion,” as appropriate.

- b.* Within this section of the auditor’s report, include a description of the matter giving rise to the modification.

**.22** If there is a material misstatement of the financial statements that relates to specific amounts in the financial statements (including quantitative disclosures), the auditor should include in the “Basis for Opinion” section a description and quantification of the financial effects of the misstatement, unless impracticable. If it is not practicable to quantify the financial effects, the auditor should state that in the “Basis for Opinion” section. (Ref: par. .A27–.A28)

**.23** If there is a material misstatement of the financial statements that relates to qualitative disclosures, the auditor should include an explanation of how the disclosures are misstated in the “Basis for Opinion” section.

**.24** If there is a material misstatement of the financial statements that relates to the omission of information required to be presented or disclosed, the auditor should do the following:

- a.* Discuss the omission of such information with those charged with governance.
- b.* Describe in the “Basis for Opinion” section the nature of the omitted information.
- c.* Include the omitted information, provided that it is practicable to do so and the auditor has obtained sufficient appropriate audit evidence about the omitted information. (Ref: par. .A29–.A30)

**.25** If the modification results from an inability to obtain sufficient appropriate audit evidence, the auditor should include the reasons for that inability in the “Basis for Opinion” section. (Ref. par. .A31)

**.26** When the auditor expresses a qualified or an adverse opinion, the auditor should amend the statement required by paragraph .28*d* of section 700 of this SAS, or paragraphs 67 or 107 of SAS *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable, about whether the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor’s opinion, to include the word “qualified” or “adverse,” as appropriate.

**.27** When the auditor disclaims an opinion on the financial statements, the auditor’s report should not include the elements required by paragraphs .28*b* and .28*d* of section 700 of this SAS or paragraphs 67*b* and 67*d* or 107*b* and 107*d* of SAS *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable. Those elements are

- a.* a reference to the section of the auditor’s report where the auditor’s responsibilities are described and
- b.* a statement about whether the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor’s opinion.

**.28** Even if the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements, the auditor should describe the reasons for any other matters of which the auditor is aware that would have required a modification to the opinion, and the effects thereof, in the “Basis for Opinion” section. (Ref: par. .A32–.A33)

***Description of Auditor's Responsibilities for the Audit of the Financial Statements When the Auditor Disclaims an Opinion on the Financial Statements***

**.29** When the auditor disclaims an opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence, the auditor should amend the description of the auditor's responsibilities required by paragraphs .35–.37 of section 700 of this SAS or paragraphs 74–76 or 115–119 of SAS *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable, to include only the following: (Ref: par. .A34)

- a. A statement that the auditor's responsibility is to conduct an audit of the entity's financial statements in accordance with auditing standards generally accepted in the United States of America and to issue an auditor's report
- b. A statement that, however, because of the matters described in the “Basis for Disclaimer of Opinion” section of the auditor's report, the auditor was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements
- c. A statement that the auditor is required to be independent and to meet other ethical responsibilities, in accordance with the relevant ethical requirements relating to the audit, required by paragraph .28c of section 700 of this SAS or paragraph 67c or 107c of SAS *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable

***Considerations When the Auditor Expresses an Adverse Opinion or Disclaims an Opinion on the Financial Statements***

**.30** When the auditor expresses an adverse opinion or disclaims an opinion on the financial statements, the auditor's report should not include a “Key Audit Matters” section in accordance with section 701 of this SAS.<sup>3</sup> (Ref: par. .A35–.A36)

**Communication With Those Charged With Governance**

**.31** When the auditor expects to modify the opinion in the auditor's report, the auditor should communicate with those charged with governance the circumstances that led to the expected modification and the wording of the modification. (Ref: par. .A37)

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<sup>3</sup> Paragraphs .10–.12 of section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, of this SAS.

## **Application and Other Explanatory Material**

### **Types of Modified Opinions (Ref: par. .02)**

**.A1** The following table illustrates how the auditor's professional judgment about the nature of the matter giving rise to the modification, and the pervasiveness of its effects or possible effects on the financial statements, affects the type of opinion to be expressed:

<i>Nature of Matter Giving Rise to the Modification</i>	<i>Auditor's Professional Judgment About the Pervasiveness of the Effects or Possible Effects on the Financial Statements</i>	
	<i>Material but Not Pervasive</i>	<i>Material and Pervasive</i>
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

### **Circumstances in Which a Modification to the Auditor's Opinion Is Required**

#### ***Nature of Material Misstatements (Ref: par. .07a)***

**.A2** Section 700 of this SAS and SAS *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA* require the auditor, in order to form an opinion on the financial statements, to conclude whether reasonable assurance has been obtained about whether the financial statements as a whole are free from material misstatement.<sup>4</sup> This conclusion takes into account the auditor's evaluation of uncorrected misstatements, if any, on the financial statements in accordance with AU-C section 450, *Evaluation of Misstatements Identified During the Audit*.

**.A3** AU-C section 450 defines a *misstatement* as a difference between the reported amount, classification, presentation, or disclosure of a financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Accordingly, a material misstatement of the financial statements may arise in relation to the following:

- The appropriateness of the selected accounting policies

<sup>4</sup> Paragraph .13 of section 700, *Forming an Opinion and Reporting on Financial Statements*, of this SAS and paragraph 38 of SAS *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*.

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- The application of the selected accounting policies
- The appropriateness of the financial statement presentation, or the appropriateness or adequacy of disclosures in the financial statements

*Appropriateness of the Selected Accounting Policies*

**.A4** Regarding the appropriateness of the accounting policies management has selected, material misstatements of the financial statements may arise, for example, when

- the selected accounting policies are not consistent with the applicable financial reporting framework,
- the financial statements do not correctly describe an accounting policy relating to a significant item therein, or
- the financial statements do not represent or disclose the underlying transactions and events in a manner that achieves fair presentation.

**.A5** Financial reporting frameworks often contain requirements for the accounting for, and disclosure of, changes in accounting policies. When the entity has changed its selection of significant accounting policies, a material misstatement of the financial statements may arise when the entity has not complied with these requirements. If a change in accounting policy does not meet the conditions described in AU-C section 708, *Consistency of Financial Statements*, then a material misstatement of the financial statements may arise.

*Application of the Selected Accounting Policies*

**.A6** Regarding the application of the selected accounting policies, material misstatements of the financial statements may arise

- when management has not applied the selected accounting policies consistently with the financial reporting framework, including when management has not applied the selected accounting policies consistently between periods or to similar transactions and events (consistency in application).
- due to the method of application of the selected accounting policies (such as an unintentional error in application).

*Appropriateness of the Financial Statement Presentation or Appropriateness or Adequacy of Disclosures in the Financial Statements*

**.A7** Regarding the appropriateness of the financial statement presentation or the appropriateness or adequacy of disclosures in the financial statements, material misstatements of the financial statements may arise when the following occur:

- The financial statements do not include all the disclosures required by the applicable financial reporting framework.
- The disclosures in the financial statements are not presented in accordance with the applicable financial reporting framework.
- The financial statements do not provide the additional disclosures necessary to achieve fair presentation beyond disclosures specifically required by the applicable financial reporting framework.
- Information required to be presented in accordance with the applicable financial reporting framework is omitted either because a required statement (for example, a statement of cash flows) has not been included or because the information has not otherwise been disclosed in the financial statements.

Paragraph .A23 of AU-C section 450 provides further examples of material misstatements that may arise in qualitative disclosures.

**.A8** Adequate disclosures relate to the presentation of the financial statements and the related notes, including, for example, the terminology used, the amount of detail given, the classification of items in the statements, and the bases of amounts set forth.

***Nature of an Inability to Obtain Sufficient Appropriate Audit Evidence (Ref: par. .07b)***

**.A9** The auditor's inability to obtain sufficient appropriate audit evidence (also referred to as a limitation on the scope of the audit) may arise from the following:

- Circumstances beyond the control of the entity
- Circumstances relating to the nature or timing of the auditor's work
- Limitations imposed by management

**.A10** An inability to perform a specific procedure does not constitute a limitation on the scope of the audit if the auditor is able to obtain sufficient appropriate audit evidence by performing alternative procedures. If this is not possible, the requirements in paragraphs .08b and .10 apply as appropriate. Limitations imposed by management may have other implications for the audit, such as for the auditor's assessment of risks of material misstatement due to fraud and consideration of engagement continuance.

**.A11** Examples of circumstances beyond the control of the entity include the following:

- The entity's accounting records have been destroyed.

## *Modification to the Opinion in the Independent Auditor's Report*

- The accounting records of a significant component have been seized indefinitely by governmental authorities.

**.A12** Examples of circumstances relating to the nature or timing of the auditor's work include the following:

- The entity is required to use the equity method of accounting for an investee, and the auditor is unable to obtain sufficient appropriate audit evidence about the latter's financial information to evaluate whether the equity method has been appropriately applied.
- The timing of the auditor's appointment is such that the auditor is unable to observe the counting of the physical inventories, and the auditor is unable to obtain sufficient appropriate audit evidence through other appropriate procedures, such as performing a rollback of inventory.
- The auditor determines that performing substantive procedures alone is not sufficient, but the entity's controls are not effective.

**.A13** Examples of an inability to obtain sufficient appropriate audit evidence arising from a limitation on the scope of the audit imposed by management include the following:

- Management prevents the auditor from observing the counting of the physical inventory.
- Management prevents the auditor from requesting external confirmation of specific account balances.

### **Determining the Type of Modification to the Auditor's Opinion**

#### ***Effect of Uncertainties (Ref: par. .10 )***

**.A14** Absence of the existence of information related to the outcome of an uncertainty does not necessarily lead to a conclusion that the audit evidence supporting management's assertion is not sufficient. Rather, the auditor's professional judgment regarding the sufficiency of the audit evidence is based on the audit evidence that is, or should be, available. If, after considering the existing conditions and available evidence, the auditor concludes that sufficient appropriate audit evidence supports management's assertions about the nature of a matter involving an uncertainty and its presentation or disclosure in the financial statements, an unmodified opinion ordinarily is appropriate.

**.A15** In cases involving multiple uncertainties, the auditor may conclude that it is not possible to form an opinion on whether the financial statements as a whole are fairly presented in accordance with the applicable financial reporting framework due to the interaction and possible cumulative effects of the uncertainties.

***Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management-Imposed Limitation After the Auditor Has Accepted the Engagement (Ref: par. .13)***

**.A16** The practicality of withdrawing from the audit may depend on the stage of completion of the engagement at the time that management imposes the scope limitation. If the auditor has substantially completed the audit, the auditor may decide to complete the audit to the extent possible, disclaim an opinion, and explain the scope limitation in the “Basis for Disclaimer of Opinion” section.

**.A17** In certain circumstances, withdrawal from the audit may not be possible if the auditor is required by law or regulation to continue the audit engagement. This may be the case for an auditor who is appointed or elected to audit the financial statements of governmental entities. It may also be the case in circumstances in which the auditor is appointed to audit the financial statements covering a specific period or is appointed for a specific period and is prohibited from withdrawing before the completion of the audit of those financial statements or before the end of that period. In such circumstances, the auditor may consider it necessary to include an other-matter paragraph in the auditor's report.<sup>5</sup>

***Other Considerations Relating to an Adverse Opinion or Disclaimer of Opinion (Ref: par. .15)***

**.A18** The following are examples of reporting circumstances that would not contradict the auditor's adverse opinion or disclaimer of opinion:

- In an initial audit, the expression of an unmodified opinion regarding the financial position and a disclaimer of opinion regarding the results of operations and cash flows, when relevant. In this case, the auditor has not disclaimed an opinion on the financial statements as a whole.
- The expression of an unmodified opinion on financial statements prepared under a given financial reporting framework and, within the same report, the expression of an adverse opinion on the same financial statements under a different financial reporting framework.

***Considerations Specific to Audits of Governmental Entities***

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<sup>5</sup> Paragraphs .10–.11 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*, of this SAS.

**.A19** Because the auditor of a state or local governmental entity expresses an opinion or disclaims an opinion for each opinion unit,<sup>6</sup> an auditor's report in these circumstances may include an unmodified opinion with respect to one or more opinion units and a modified opinion for one or more other opinion units.

***Auditor Is Not Independent but Is Required by Law or Regulation to Report on the Financial Statements (Ref: par. .16)***

*Considerations Specific to Governmental Entities*

**.A20** The nature of a government auditor's lack of independence may have a limited effect because the impairment may result from the government auditor's association with only a component of the overall governmental entity. A government auditor may determine that the lack of independence affects only one or more, but not all, of the governmental entity's opinion units, and in such circumstances, the auditor may disclaim an opinion on the affected opinion units while expressing unmodified, qualified, or adverse opinions on other opinion units. The more significant the affected opinion units are to the overall governmental entity, the more likely that it will be appropriate for the auditor to disclaim an opinion on the financial statements of the overall governmental entity.

**Form and Content of the Auditor's Report When the Opinion Is Modified**

***Illustrative Auditor's Reports (Ref: par. .17)***

**.A21** Illustrations 1 and 3 in the exhibit to this section contain auditor's reports with qualified and adverse opinions, respectively, because the financial statements are materially misstated.

**.A22** Illustration 4 in the exhibit contains an auditor's report with a qualified opinion because the auditor is unable to obtain sufficient appropriate audit evidence. Illustration 5 contains a disclaimer of opinion due to an inability to obtain sufficient appropriate audit evidence about a single element of the financial statements. Illustration 6 contains a disclaimer of opinion due to an inability to obtain sufficient appropriate audit evidence about multiple elements of the financial statements. In each of the latter two cases, the possible effects on the financial statements of the inability to obtain sufficient appropriate audit evidence are both material and pervasive. The exhibits to other AU-C sections that include reporting requirements also include illustrations of auditor's reports with modified opinions.

***Auditor's Opinion (Ref: par. .17)***

**.A23** Amending the heading required by paragraph .17 makes it clear to the user that the auditor's opinion is modified and indicates the type of modification.

***Qualified Opinion (Ref: par. .18)***

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<sup>6</sup> Paragraph .A6 of section 700, *Forming an Opinion and Reporting on Financial Statements*, of this SAS.

**.A24** When the auditor expresses a qualified opinion, it would not be appropriate to use phrases such as “with the foregoing explanation” or “subject to” in the “Opinion” section because these are not sufficiently clear or forceful. Because accompanying notes are part of the financial statements, wording such as “fairly presented, in all material respects, when read in conjunction with note 1” is likely to be misunderstood and would also not be appropriate.

**.A25** When the auditor expresses a qualified opinion due to a scope limitation, paragraph .18 requires that the auditor state in the opinion paragraph that the qualification pertains to the possible effects of the matter on the financial statements and not to the scope limitation itself. Wording such as “In our opinion, except for the above-mentioned limitation on the scope of our audit...” bases the exception on the restriction itself rather than on the possible effects on the financial statements and, therefore, is unacceptable.

***Basis for Opinion (Ref: par. .21, .22, .24, .28)***

**.A26** Consistency in the auditor’s report helps promote users’ understanding and helps users identify unusual circumstances when they occur. Accordingly, although uniformity in the wording of a modified opinion and the description of the reasons for the modification may not be possible, consistency in both the form and content of the auditor’s report is desirable.

**.A27** An example of the financial effects of misstatements that the auditor may describe within the “Basis for Opinion” section in the auditor’s report is the quantification of the effects on income before taxes, income taxes, net income, and equity if inventory is overstated. If such disclosures are made in a note to the financial statements, the “Basis for Opinion” section may refer to the note.

**.A28** In considering the adequacy of disclosure, and in other aspects of the audit, the auditor uses information received in confidence from management. Without such confidence, the auditor would find it difficult to obtain information necessary to form an opinion on the financial statements. The “Confidential Client Information Rule” (ET sec. 1.700.001)<sup>‡</sup> of the AICPA Code of Professional Conduct states that the auditor should not disclose any confidential client information without the specific consent of the client. Accordingly, the auditor may not make available, without management’s consent, information that is not required to be disclosed in the financial statements to comply with the applicable financial reporting framework.

**.A29** *Practicable*, as used in the context of paragraphs .22 and .24c, means that the information is reasonably obtainable from management’s accounts and records and that providing the information in the report does not require the auditor to assume the position of a preparer of financial information. For example, the auditor would not be expected to prepare a basic financial statement and include it in the auditor’s report when management omits such information.

**.A30** Disclosing the omitted information within the “Basis for Opinion” section would not be practicable if

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<sup>‡</sup> All ET sections can be found in AICPA *Professional Standards*.

## *Modification to the Opinion in the Independent Auditor's Report*

- the information has not been prepared by management or the information is otherwise not readily available to the auditor or,
- in the auditor's judgment, the information would be unduly voluminous in relation to the auditor's report.

**.A31** When the auditor modifies the opinion due to an inability to obtain sufficient appropriate audit evidence, it is not appropriate for the scope of the audit to be explained in a note to the financial statements because the description of the audit scope is the responsibility of the auditor and not that of management.

**.A32** An adverse opinion or a disclaimer of opinion relating to a specific matter described within the "Basis for Opinion" section does not justify the omission of a description of other identified matters that would have otherwise required a modification of the auditor's opinion. In such cases, the disclosure of such other matters of which the auditor is aware may be relevant to users of the financial statements.

**.A33** The auditor may consider whether there is a need to describe in an emphasis-of-matter or other-matter paragraph<sup>7</sup> any other matters of which the auditor is aware that would not require a modification of the auditor's opinion.

### ***Description of Auditor's Responsibilities for the Audit of the Financial Statements When the Auditor Disclaims an Opinion on the Financial Statements (Ref: par. .29)***

**.A34** When the auditor disclaims an opinion on the financial statements, the following statements are better positioned within the "Auditor's Responsibilities for the Audit of the Financial Statements" section of the auditor's report, as illustrated in illustrations 5–6 of the exhibit to this section:

- The statement required by paragraph .28a of section 700 of this SAS or paragraph 67a or 107a of SAS *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable, amended to state that the auditor's responsibility is to conduct an audit of the entity's financial statements in accordance with auditing standards generally accepted in the United States of America
- The statement required by paragraph .28c of section 700 of this SAS or paragraph 67c or 107c of SAS *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as applicable, about independence and other ethical responsibilities

### ***Considerations When the Auditor Issues an Adverse Opinion or Disclaims an Opinion on the Financial Statements (Ref: par. .30)***

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<sup>7</sup> See section 706 of this SAS.

**.A35** Describing the reasons for the modification of the opinion within the “Basis for Opinion” section of the auditor’s report provides information to users that is useful in understanding why the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements. Furthermore, describing these reasons may guard against inappropriate reliance on the financial statements. However, providing further details about the audit may overshadow the reasons for the modification of the opinion and may potentially be confusing to users.

**.A36** When the auditor expresses an adverse opinion, the communication of any key audit matters other than the matters giving rise to the modified opinion may overshadow the fact that the financial statements as a whole are materially misstated. When the auditor disclaims an opinion, the communication of any key audit matters other than the matters giving rise to the disclaimer of opinion may suggest that the financial statements are more credible in relation to those matters than would be appropriate in the circumstances and would be inconsistent with the disclaimer of opinion on the financial statements as a whole. Accordingly, paragraph .30 of this section prohibits the inclusion of a “Key Audit Matters” section in the auditor’s report when the auditor issues an adverse opinion or disclaims an opinion on the financial statements.

#### **Communication With Those Charged With Governance (Ref: par. .31)**

**.A37** Communicating with those charged with governance the circumstances that led to an expected modification to the auditor’s opinion and the wording of the modification enables the following:

- The auditor to give notice to those charged with governance of the intended modification and the reasons (or circumstances) for the modification
- The auditor to seek the concurrence of those charged with governance regarding the facts of the matters giving rise to the expected modification, or to confirm matters of disagreement with management as such
- Those charged with governance to have an opportunity, when appropriate, to provide the auditor with further information and explanations regarding the matters giving rise to the expected modification

**.A38**

**Exhibit — Illustrations of Auditor's Reports With Modifications to the Opinion**

Illustration 1: An Auditor's Report Containing a Qualified Opinion Due to a Material Misstatement of the Financial Statements

Illustration 2: An Auditor's Report Containing a Qualified Opinion for Inadequate Disclosure

Illustration 3: An Auditor's Report Containing an Adverse Opinion Due to a Material Misstatement of the Financial Statements

Illustration 4: An Auditor's Report Containing a Qualified Opinion Due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence

Illustration 5: An Auditor's Report Containing a Disclaimer of Opinion Due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence About a Single Element of the Financial Statements

Illustration 6: An Auditor's Report Containing a Disclaimer of Opinion Due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence About Multiple Elements of the Financial Statements

Illustration 7: An Auditor's Report in Which the Auditor Is Expressing an Unmodified Opinion in the Prior Year and a Modified Opinion (Qualified Opinion) in the Current Year

Illustration 8: An Auditor's Report in Which the Auditor Is Expressing an Unmodified Opinion in the Current Year and a Disclaimer of Opinion on the Prior-Year Statements of Income, Changes in Stockholders' Equity, and Cash Flows

**Illustration 1: An Auditor's Report Containing a Qualified Opinion Due to a Material Misstatement of the Financial Statements**

Circumstances include the following:

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

**Independent Auditor's Report**

[Appropriate Addressee]

**Report on the Audit of the Financial Statements<sup>1</sup>**

***Qualified Opinion***

We have audited the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X1 and 20X0, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

***Basis for Qualified Opinion***

ABC Company has stated inventories at cost in the accompanying balance sheets. Accounting principles generally accepted in the United States of America require inventories to be stated at the lower of cost or market. If the Company stated inventories at the lower of cost or market, a write down of \$XXX and \$XXX would have been required as of December 31, 20X1 and 20X0, respectively. Accordingly, cost of sales would have been increased by \$XXX and \$XXX, and net income, income taxes, and stockholders' equity would have been reduced by \$XXX, \$XXX, and \$XXX, and \$XXX, \$XXX, and \$XXX, as of and for the years ended December 31, 20X1 and 20X0, respectively.

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

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<sup>1</sup> The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

***Responsibilities of Management for the Financial Statements***

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

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

***Auditor's Responsibilities for the Audit of the Financial Statements***

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

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing

*Modification to the Opinion in the Independent Auditor's Report*

an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>2</sup>

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

**Report on Other Legal and Regulatory Requirements**

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

*[Signature of the auditor's firm]*

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

*[Date of the auditor's report]*

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<sup>2</sup> In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

**Illustration 2: An Auditor's Report Containing a Qualified Opinion for Inadequate Disclosure**

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in AU-C section 210, *Terms of Engagement*.
- The financial statements have inadequate disclosures. The auditor has concluded that (a) it is not practicable to present the required information and (b) the effects are such that an adverse opinion is not appropriate. Accordingly, the auditor's report contains a qualified opinion.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has been engaged to communicate key audit matters.

**Independent Auditor's Report**

[Appropriate Addressee]

**Report on the Audit of the Financial Statements<sup>1</sup>**

***Qualified Opinion***

We have audited the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X1 and 20X0, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, except for the omission of the information described in the Basis for Qualified Opinion section of our report, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

***Basis for Qualified Opinion***

ABC Company's financial statements do not disclose [*describe the nature of the omitted information that is not practicable to present in the auditor's report*]. In our opinion, disclosure of this information is required by accounting principles generally accepted in the United States of America.

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

***Key Audit Matters***

Key audit matters are those matters that were communicated with those charged with governance and, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial

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<sup>1</sup> The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

*[Description of each key audit matter in accordance with section 701, Communicating Key Audit Matters in the Independent Auditor's Report, of this SAS]*

### ***Responsibilities of Management for the Financial Statements***

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

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

### ***Auditor's Responsibilities for the Audit of the Financial Statements***

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

In performing an audit in accordance with GAAS, we:

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

*Modification to the Opinion in the Independent Auditor's Report*

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>2</sup>
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

**Report on Other Legal and Regulatory Requirements**

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

*[Signature of the auditor's firm]*

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

*[Date of the auditor's report]*

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<sup>2</sup> In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

**Illustration 3: An Auditor's Report Containing an Adverse Opinion Due to a Material Misstatement of the Financial Statements**

Circumstances include the following:

- Audit of a complete set of consolidated general purpose financial statements (single year). The audit is a group audit. The auditor is not making reference to a component auditor in the auditor's report.
- Management is responsible for the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in AU-C section 210, *Terms of Engagement*.
- The financial statements are materially misstated due to the nonconsolidation of a subsidiary. The material misstatement is deemed to be pervasive to the financial statements. Accordingly, the auditor's report contains an adverse opinion. The effects of the misstatement on the financial statements have not been determined because it was not practicable to do so.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor is precluded from communicating key audit matters when issuing an adverse opinion.

**Independent Auditor's Report**

[Appropriate Addressee]

**Report on the Audit of the Consolidated Financial Statements<sup>1</sup>**

***Adverse Opinion***

We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheet as of December 31, 20X1, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion section of our report, the accompanying consolidated financial statements do not present fairly the financial position of ABC Company and its subsidiaries as of December 31, 20X1, or the results of their operations or their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

***Basis for Adverse Opinion***

As described in Note X, ABC Company has not consolidated the financial statements of subsidiary XYZ Company that it acquired during 20X1 because it has not yet been able to ascertain the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This investment is therefore accounted for on a cost basis by the Company. Under accounting principles generally accepted in the United States of America, the subsidiary should have been consolidated because it is controlled by the Company. Had XYZ Company been consolidated, many elements in the accompanying consolidated financial statements would have been materially affected. The effects on the consolidated financial statements of the failure to consolidate have not been determined.

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

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<sup>1</sup> The subtitle "Report on the Audit of the Consolidated Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

***Responsibilities of Management for the Financial Statements***

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

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

***Auditor's Responsibilities for the Audit of the Financial Statements***

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

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing

*Modification to the Opinion in the Independent Auditor's Report*

an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>2</sup>

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

**Report on Other Legal and Regulatory Requirements**

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

*[Signature of the auditor's firm]*

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

*[Date of the auditor's report]*

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<sup>2</sup> In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

**Illustration 4: An Auditor's Report Containing a Qualified Opinion Due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence**

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (single year). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in AU-C section 210, *Terms of Engagement*.
- The auditor was unable to obtain sufficient appropriate audit evidence regarding an investment in a foreign affiliate. The possible effects of the inability to obtain sufficient appropriate audit evidence are deemed to be material but not pervasive to the financial statements. Accordingly, the auditor's report contains a qualified opinion.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters.

**Independent Auditor's Report**

[Appropriate Addressee]

**Report on the Audit of the Financial Statements<sup>1</sup>**

***Qualified Opinion***

We have audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion section of our report, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

***Basis for Qualified Opinion***

ABC Company's investment in XYZ Company, a foreign affiliate acquired during the year and accounted for under the equity method, is carried at \$XXX on the balance sheet at December 31, 20X1, and ABC Company's share of XYZ Company's net income of \$XXX is included in ABC Company's net income for the year then ended. We were unable to obtain sufficient appropriate audit evidence about the carrying amount of ABC Company's investment in XYZ Company as of December 31, 20X1, and ABC Company's share of XYZ Company's net income for the year then ended because we were denied access to the financial information, management, and the auditors of XYZ Company. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.

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

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<sup>1</sup> The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

***Responsibilities of Management for the Financial Statements***

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

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

***Auditor's Responsibilities for the Audit of the Financial Statements***

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

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing

*Modification to the Opinion in the Independent Auditor's Report*

an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>2</sup>

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

**Report on Other Legal and Regulatory Requirements**

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

*[Signature of the auditor's firm]*

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

*[Date of the auditor's report]*

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<sup>2</sup> In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

**Illustration 5: An Auditor's Report Containing a Disclaimer of Opinion Due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence About a Single Element of the Financial Statements**

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (single year). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in AU-C section 210, *Terms of Engagement*.
- The auditor was unable to obtain sufficient appropriate audit evidence about a single element of the financial statements. That is, the auditor was unable to obtain audit evidence about the financial information of a joint venture investment accounted for under the proportionate consolidation approach. The investment represents over 90 percent of the Company's net assets. The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements. Accordingly, the auditor's report contains a disclaimer of opinion.
- The auditor concluded that it was unnecessary to include in the auditor's report specific amounts for the Company's proportional share of the assets, liabilities, income, and expenses of the joint venture investment because the investment represents over 90 percent of the Company's net assets, and that fact is disclosed in the auditor's report.
- The auditor is precluded from communicating key audit matters when disclaiming an opinion on the financial statements.
- A more limited description of the Auditor's Responsibilities section is required because of the disclaimer of opinion.

**Independent Auditor's Report**

[Appropriate Addressee]

**Report on the Audit of the Financial Statements<sup>1</sup>**

***Disclaimer of Opinion***

We were engaged to audit the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

We do not express an opinion on the accompanying financial statements of ABC Company. Because of the significance of the matter described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements.

***Basis for Disclaimer of Opinion***

ABC Company's investment in XYZ Company, a joint venture, is carried at \$XXX on the Company's balance sheet, which represents over 90 percent of the Company's net assets as of December 31, 20X1. We were not allowed access to the management and the auditors of XYZ Company. As a result, we were unable to determine whether any adjustments were necessary relating to the Company's proportional share of XYZ Company's assets that it controls jointly, its proportional share of XYZ Company's liabilities for which it is jointly responsible, its proportional share of XYZ Company's income and expenses for the year, and the elements making up the statements of changes in stockholders' equity and cash flows.

***Responsibilities of Management for the Financial Statements***

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC

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<sup>1</sup> The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

*Modification to the Opinion in the Independent Auditor's Report*

Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

***Auditor's Responsibilities for the Audit of the Financial Statements***

Our responsibility is to conduct an audit of ABC Company's financial statements in accordance with auditing standards generally accepted in the United States of America and to issue an auditor's report. However, because of the matter described in the Basis for Disclaimer of Opinion section of our report, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

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

**Report on Other Legal and Regulatory Requirements**

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

*[Signature of the auditor's firm]*

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

*[Date of the auditor's report]*

**Illustration 6: An Auditor's Report Containing a Disclaimer of Opinion Due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence About Multiple Elements of the Financial Statements**

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (single year). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in AU-C section 210, *Terms of Engagement*.
- The auditor was unable to obtain sufficient appropriate audit evidence about multiple elements of the financial statements. That is, the auditor was unable to obtain audit evidence about the entity's inventories and accounts receivable at year-end because at that time the auditor had not been engaged. The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements. Accordingly, the auditor's opinion contains a disclaimer of opinion.
- The auditor is precluded from communicating key audit matters when disclaiming an opinion on the financial statements.
- A more limited description of the Auditor's Responsibilities section is required because of the disclaimer of opinion.

**Independent Auditor's Report**

[Appropriate Addressee]

**Report on the Audit of the Financial Statements<sup>1</sup>**

***Disclaimer of Opinion***

We were engaged to audit the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

We do not express an opinion on the accompanying financial statements of ABC Company. Because of the significance of the matters described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

***Basis for Disclaimer of Opinion***

We were not engaged as auditors of ABC Company until after December 31, 20X1, and, therefore, did not observe the counting of physical inventories at the beginning or end of the year. We were unable to satisfy ourselves by other auditing procedures concerning the inventory held at December 31, 20X1, which is stated in the balance sheet at \$XXX. In addition, the introduction of a new computerized accounts receivable system in September 20X1 resulted in numerous misstatements in accounts receivable. As of the date of our audit report, management was still in the process of rectifying the system deficiencies and correcting the misstatements. We were unable to confirm or verify by alternative means accounts receivable included in the balance sheet at a total amount of \$XXX at December 31, 20X1. As a result of these matters, we were unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded inventories and accounts receivable, and the elements making up the statements of income, changes in stockholders' equity, and cash flows.

***Responsibilities of Management for the Financial Statements***

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and

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<sup>1</sup> The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

*Modification to the Opinion in the Independent Auditor's Report*

fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

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

***Auditor's Responsibilities for the Audit of the Financial Statements***

Our responsibility is to conduct an audit of ABC Company's financial statements in accordance with auditing standards generally accepted in the United States of America and to issue an auditor's report. However, because of the matters described in the Basis for Disclaimer of Opinion section of our report, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

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

**Report on Other Legal and Regulatory Requirements**

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

*[Signature of the auditor's firm]*

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

*[Date of the auditor's report]*

**Illustration 7: An Auditor's Report in Which the Auditor Is Expressing an Unmodified Opinion in the Prior Year and a Modified Opinion (Qualified Opinion) in the Current Year**

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in AU-C section 210, *Terms of Engagement*.
- Certain lease obligations have been excluded from the financial statements in the current year. The effect of the exclusion is material but not pervasive. The auditor expressed an unmodified opinion in the prior year and is expressing a modified opinion (qualified opinion) in the current year.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters.

**Independent Auditor's Report**

[Appropriate Addressee]

**Report on the Audit of the Financial Statements<sup>1</sup>**

***Qualified Opinion***

We have audited the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X1 and 20X0, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, except for the effects on the accompanying 20X1 financial statements of not capitalizing certain lease obligations as described in the Basis for Qualified Opinion section of our report, the financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

***Basis for Qualified Opinion on the 20X1 Financial Statements***

ABC Company has excluded, from property and debt in the accompanying 20X1 balance sheet, certain lease obligations that were entered into in 20X1 that, in our opinion, should be capitalized in accordance with accounting principles generally accepted in the United States of America. If these lease obligations were capitalized, property would be increased by \$XXX, long-term debt by \$XXX, and retained earnings by \$XXX as of December 31, 20X1, and net income and earnings per share would be increased (decreased) by \$XXX and \$XXX, respectively, for the year then ended.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion on the 20X1 financial statements and for our opinion on the 20X0 financial statements.

***Responsibilities of Management for the Financial Statements***

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<sup>1</sup> The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

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

### ***Auditor's Responsibilities for the Audit of the Financial Statements***

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

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>2</sup>

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<sup>2</sup> In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of

*Modification to the Opinion in the Independent Auditor's Report*

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

**Report on Other Legal and Regulatory Requirements**

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

*[Signature of the auditor's firm]*

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

*[Date of the auditor's report]*

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expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

**Illustration 8: An Auditor's Report in Which the Auditor Is Expressing an Unmodified Opinion in the Current Year and a Disclaimer of Opinion on the Prior-Year Statements of Income, Changes in Stockholders' Equity, and Cash Flows**

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in AU-C section 210, *Terms of Engagement*.
- The auditor was unable to observe the physical inventory as of December 31, 20X0, because at that time the auditor had not been engaged. Accordingly, the auditor was unable to obtain sufficient appropriate audit evidence regarding the net income and cash flows for the year ended December 31, 20X1. The effects of the inability to obtain sufficient appropriate audit evidence are deemed material and pervasive.
- In accordance with paragraph .A26 of section 700 of this SAS, the opinion does not separately refer to the statement of changes in stockholders' equity because changes in stockholders' equity accounts are considered part of the presentation of financial position, results of operations, and cash flows.
- The auditor expressed an unmodified opinion on the December 31, 20X2 and 20X1, balance sheets and a disclaimer of opinion on the 20X1 statements of income, changes in stockholders' equity, and cash flows.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters.

**Independent Auditor's Report**

[Appropriate Addressee]

**Report on the Audit of the Financial Statements<sup>1</sup>**

***Opinion***

We have audited the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X2 and 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying balance sheets of ABC Company as of December 31, 20X2 and 20X1, and the statements of income, changes in stockholders' equity, and cash flows for the year ended December 31, 20X2, present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X2 and 20X1, and the results of its operations and its cash flows for the year ended December 31, 20X2, in accordance with accounting principles generally accepted in the United States of America.

***Disclaimer of Opinion on 20X1 Operations and Cash Flows***

We do not express an opinion on the accompanying results of operations and cash flows for the year ended December 31, 20X1. Because of the significance of the matter described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the results of operations and cash flows.

***Basis for Opinion***

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion on the balance sheets as of December 31, 20X2 and 20X1, and the statements of income, changes in stockholders' equity, and cash flows for the year ended December 31, 20X2.

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<sup>1</sup> The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

***Basis for Disclaimer of Opinion on 20X1 Operations and Cash Flows***

We did not observe the taking of the physical inventory as of December 31, 20X0, because that date was prior to our engagement as auditors for ABC Company, and we were unable to satisfy ourselves regarding inventory quantities by means of other auditing procedures. Inventory amounts as of December 31, 20X0, enter into the determination of net income and cash flows for the year ended December 31, 20X1.

***Responsibilities of Management for the Financial Statements***

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

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

***Auditor's Responsibilities for the Audit of the Financial Statements***

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

In performing an audit in accordance with GAAS, we:

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

*Modification to the Opinion in the Independent Auditor's Report*

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>2</sup>
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

**Report on Other Legal and Regulatory Requirements**

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

*[Signature of the auditor's firm]*

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

*[Date of the auditor's report]*

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<sup>2</sup> In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

## **AU-C Section 706**

# ***Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report***

### **Introduction**

#### **Scope of This Section**

**.01** This section addresses additional communications in the auditor's report when the auditor considers it necessary to

- a.* draw users' attention to a matter or matters presented or disclosed in the financial statements that are of such importance that they are fundamental to users' understanding of the financial statements (emphasis-of-matter paragraph); or
- b.* draw users' attention to any matters other than those presented or disclosed in the financial statements that are relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report (other-matter paragraph).

**.02** The communication of key audit matters is not required by section 700, *Forming an Opinion and Reporting on Financial Statements*, of this Statement on Auditing Standards (SAS), SAS *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*,\* or section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, of this SAS. However, when the auditor is engaged to communicate key audit matters, this section addresses the relationship between key audit matters and any additional communication in the auditor's report in accordance with this section. (Ref: par. .A1)

**.03** AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*,† addresses communication in the auditor's report relating to going concern. (Ref. par. .A2)

**.04** Exhibit B, "List of AU-C Sections Containing Requirements for Emphasis-of-Matter Paragraphs," and exhibit C, "List of AU-C Sections Containing Requirements for Other-Matter Paragraphs," of this section identify AU-C sections containing specific requirements for the auditor to include an emphasis-of-matter paragraph or other-matter paragraph, respectively, in the auditor's report. When an emphasis-of-matter or other-matter paragraph is required, the requirements in this section regarding the form of such paragraphs apply. (Ref: par. .A3)

#### **Effective Date**

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\* Statement on Auditing Standards (SAS) *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA* is expected to be issued as a final SAS in the second half of 2019.

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

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

## **Objective**

**.06** The objective of the auditor, having formed an opinion on the financial statements, is to draw users' attention, when in the auditor's judgment it is necessary to do so, by way of clear additional communication in the auditor's report, to the following:

- a.* A matter, although appropriately presented or disclosed in the financial statements, that is of such importance that it is fundamental to users' understanding of the financial statements
- b.* As appropriate, any other matter that is relevant to users' understanding of the audit, the auditor's responsibilities, or the auditor's report

## **Definitions**

**.07** For purposes of generally accepted auditing standards (GAAS), the following terms have the meanings attributed as follows:

**Emphasis-of-matter paragraph.** A paragraph included in the auditor's report that is required by GAAS, or is included at the auditor's discretion, and that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's professional judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

**Other-matter paragraph.** A paragraph included in the auditor's report that is required by GAAS, or is included at the auditor's discretion, and that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's professional judgment, is relevant to users' understanding of the audit, the auditor's responsibilities, or the auditor's report.

## **Requirements**

### **Emphasis-of-Matter Paragraphs in the Auditor's Report**

**.08** If the auditor considers it necessary to draw users' attention to a matter appropriately presented or disclosed in the financial statements that, in the auditor's professional judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor should include an emphasis-of-matter paragraph in the auditor's report, provided that the following apply: (Ref: par. .A4–.A5)

- a.* The auditor would not be required to modify the opinion in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*, of this SAS as a result of the matter.

- b. When section 701 of this SAS applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report. (Ref: par. .A1 )

**.09** When the auditor includes an emphasis-of-matter paragraph in the auditor's report, the auditor should do the following:

- a. Include the paragraph within a separate section of the auditor's report with an appropriate heading. When key audit matters are communicated in the auditor's report, the heading should include the term "Emphasis of Matter." (Ref. par. .A6)
- b. Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements. The paragraph should refer only to information presented or disclosed in the financial statements.
- c. Indicate that the auditor's opinion is not modified with respect to the matter emphasized. (Ref: par. .A7–.A8, .A14–.A15)

### **Other-Matter Paragraphs in the Auditor's Report**

**.10** If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's professional judgment, is relevant to users' understanding of the audit, the auditor's responsibilities, or the auditor's report, the auditor should include an other-matter paragraph in the auditor's report, provided that, when section 701 of this SAS applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report. (Ref: par. .A9–.A12)

**.11** When the auditor includes an other-matter paragraph in the auditor's report, the auditor should include the paragraph within a separate section with the heading "Other Matter" or other appropriate heading. (Ref: par. .A13–.A15)

### **Communication With Those Charged With Governance**

**.12** If the auditor expects to include an emphasis-of-matter or other-matter paragraph in the auditor's report, the auditor should communicate with those charged with governance regarding this expectation and the wording of the paragraph. (Ref: par. .A16)

### **Application and Other Explanatory Material**

#### **Scope of This Section (Ref: par. .01–.04)**

*The Relationship Between Emphasis-of-Matter Paragraphs and Key Audit Matters in the Auditor's Report (Ref: par. .02–.04, .08b)*

**.A1** *Key audit matters* are defined in section 701 of this SAS as those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance, which include significant findings from the audit of the financial

statements of the current period.<sup>1</sup> Communicating key audit matters provides additional information to intended users of the financial statements to assist them in understanding those matters that, in the auditor's professional judgment, were of most significance in the audit and may also assist them in understanding the entity and areas of significant management judgment in the audited financial statements. When section 701 of this SAS applies, the use of emphasis-of-matter paragraphs is not a substitute for a description of individual key audit matters.

**.A2** If, after considering identified conditions or events and management's plans, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains, the auditor is required to include a separate section in the auditor's report under the heading "Substantial Doubt About the Entity's Ability to Continue as a Going Concern."<sup>2</sup> If conditions or events, considered in the aggregate, have been identified that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time but, based on the audit evidence obtained, the auditor concludes that substantial doubt has been alleviated by management's plans and adequate disclosure has been made in the financial statements, the auditor may include an emphasis-of-matter paragraph in accordance with this section, making reference to management's disclosures related to the conditions and events and management's plans related to those conditions and events.<sup>3</sup>

**.A3** The AU-C sections identified in exhibits B and C require the auditor to include an emphasis-of-matter paragraph or other-matter paragraph, respectively, in the auditor's report relating to certain matters. The nature of these matters is such that they are brought to the attention of users of the auditor's report in all instances rather than at the discretion of the auditor. The explanatory language provided by such required paragraphs achieves the same objective as an emphasis-of-matter or other-matter paragraph that is included based on the professional judgment of the auditor (that is, to provide additional communication to the users of the auditor's report). Therefore, the auditor follows the requirements in this section regarding the form of these required paragraphs.

## **Emphasis-of-Matter Paragraphs in the Auditor's Report**

### ***Circumstances in Which an Emphasis-of-Matter Paragraph May Be Necessary (Ref: par. .08)***

**.A4** In addition to the required emphasis-of-matter paragraphs listed in exhibit B, the following are examples of circumstances in which the auditor may consider it necessary to include an emphasis-of-matter paragraph:

- An uncertainty relating to the future outcome of unusually important litigation or regulatory action

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<sup>1</sup> Paragraph .14 of AU-C section 260, *The Auditor's Communication With Those Charged With Governance*.

<sup>2</sup> Paragraph .24 of AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.

<sup>3</sup> Paragraphs .A54–.A56 of AU-C section 570.

- A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report<sup>4</sup>
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position or results of operations
- Significant transactions with related parties

**.A5** Paragraph .08 requires that an emphasis-of-matter paragraph refer only to matters appropriately presented or disclosed in the financial statements. To include information in an emphasis-of-matter paragraph about a matter beyond what is presented or disclosed in the financial statements may raise questions about the appropriateness of such presentation or disclosure.

***Including an Emphasis-of-Matter Paragraph in the Auditor's Report (Ref: par. .09)***

**.A6** The term "Emphasis of Matter" is required to be included in the heading when key audit matters are communicated to clearly differentiate the matter in the emphasis-of-matter paragraph from those included in the Key Audit Matters section of the auditor's report. The auditor may add further context to the heading "Emphasis of Matter" (for example, "Emphasis of Matter — Subsequent Event") to further describe the nature of the matter addressed by the emphasis-of-matter paragraph.

**.A7** The inclusion of an emphasis-of-matter paragraph in the auditor's report does not affect the auditor's opinion. An emphasis-of-matter paragraph is not a substitute for the following:

- A modified opinion in accordance with section 705 of this SAS when required by the circumstances of a specific audit engagement
- Disclosures in the financial statements that the applicable financial reporting framework requires management to make or that are otherwise necessary to achieve fair presentation
- Reporting in accordance with AU-C section 570 when, after considering identified conditions or events and management's plans, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains, in which case the auditor is required to include a separate section in the auditor's report (see paragraph .A2)

**.A8** Paragraphs .A14–.A15 provide further guidance on the placement of emphasis-of-matter paragraphs in particular circumstances.

**Other-Matter Paragraphs in the Auditor's Report (Ref: par. .10–.11)**

***Circumstances in Which an Other-Matter Paragraph May Be Necessary***

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<sup>4</sup> Paragraph .7 of AU-C section 560, *Subsequent Events and Subsequently Discovered Facts*.

*Relevant to Users' Understanding of the Audit*

**.A9** When the auditor is unable to withdraw from an engagement, even though the possible effect of an inability to obtain sufficient appropriate audit evidence due to a limitation on the scope of the audit imposed by management is pervasive,<sup>5</sup> the auditor may consider it necessary to include an other-matter paragraph in the auditor's report to explain why it is not possible for the auditor to withdraw from the engagement.

*Relevant to Users' Understanding of the Auditor's Responsibilities or the Auditor's Report*

**.A10** Law, regulation, or generally accepted practice may require or permit the auditor to elaborate on matters that provide further explanation of the auditor's responsibilities in the audit of the financial statements or of the auditor's report thereon. When the "Other Matter" section includes more than one matter that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities, or the auditor's report, it may be helpful to use different subheadings for each matter.

**.A11** An other-matter paragraph does not address circumstances in which the auditor has other reporting responsibilities that are in addition to the auditor's responsibility under GAAS (see the section "Other Reporting Responsibilities" in section 700 of this SAS or SAS *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*) or when the auditor has been asked to perform and report on additional specified procedures or to express an opinion on specific matters.

*Reporting on More Than One Set of Financial Statements*

**.A12** An entity may prepare one set of financial statements in accordance with a general purpose framework (for example, accounting principles generally accepted in the United States of America) and another set of financial statements in accordance with another general purpose framework (for example, International Financial Reporting Standards promulgated by the International Accounting Standards Board) and engage the auditor to report on both sets of financial statements. If the auditor has determined that the frameworks are acceptable in the respective circumstances, the auditor may include an other-matter paragraph in the auditor's report, referring to the fact that another set of financial statements has been prepared by the same entity in accordance with another general purpose framework and that the auditor has issued a report on those financial statements.

*Including an Other-Matter Paragraph in the Auditor's Report*

**.A13** The content of an other-matter paragraph clearly reflects that such other matter is not required to be presented and disclosed in the financial statements. An other-matter paragraph does not include information that the auditor is prohibited from providing by law, regulation, or other professional standards (for example, ethical standards relating to confidentiality of information). An other-matter paragraph also does not include information that is required to be provided by

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<sup>5</sup> See paragraph .13 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*, of this SAS for a discussion of this circumstance.

management.

### **Placement of Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Auditor's Report (Ref: par. .09, .11)**

**.A14** This section does not specify the placement of an emphasis-of-matter paragraph or other-matter paragraph in the auditor's report. Rather, the placement depends on the nature of the information to be communicated and the auditor's judgment about the relative significance of such information to intended users compared to other elements required to be reported in accordance with section 700 of this SAS or SAS *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*. The following are examples of considerations related to the placement of emphasis-of-matter and other-matter paragraphs:

- *Emphasis-of-Matter Paragraphs.* When a "Key Audit Matters" section is presented in the auditor's report, an emphasis-of-matter paragraph may be presented either directly before or after the "Key Audit Matters" section, based on the auditor's judgment about the relative significance of the information included in the emphasis-of-matter paragraph. The auditor may also add further context to the heading "Emphasis of Matter," such as "Emphasis of Matter — Subsequent Event," to differentiate the emphasis-of-matter paragraph from the individual matters described in the "Key Audit Matters" section.
- *Other-Matter Paragraphs.*
  - When a "Key Audit Matters" section is presented in the auditor's report and an other-matter paragraph is also considered necessary, the auditor may add further context to the heading "Other Matter," such as "Other Matter — Scope of the Audit," to differentiate the other-matter paragraph from the individual matters described in the "Key Audit Matters" section.
  - When an other-matter paragraph is included to draw users' attention to a matter relating to other reporting responsibilities addressed in the auditor's report, the paragraph may be included in the section "Report on Other Legal and Regulatory Requirements."
  - When it is relevant to all the auditor's responsibilities or to users' understanding of the auditor's report, the other-matter paragraph may be included as a separate section following the sections "Report on the Audit of the Financial Statements" and "Report on Other Legal and Regulatory Requirements."

**.A15** Illustration 2 in exhibit A shows the interaction between the "Key Audit Matters" section, an emphasis-of-matter paragraph, and an other-matter paragraph when all are presented in the auditor's report.

### **Communication With Those Charged With Governance (Ref. par. .12)**

**.A16** The auditor's communication with those charged with governance required by paragraph .12 enables those charged with governance to be made aware of the nature of any specific matters

that the auditor intends to highlight in the auditor's report and provides them with an opportunity to obtain further clarification from the auditor when necessary. As discussed in paragraph .A50<sup>‡</sup> of AU-C section 260, *The Auditor's Communication With Those Charged With Governance*, certain matters may be important to communicate prior to the issuance of the auditor's report. When the inclusion of an other-matter paragraph on a particular matter in the auditor's report recurs on each successive engagement, the auditor may determine that it is unnecessary to repeat the communication on each engagement.

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<sup>‡</sup> This reference is to paragraph .A50 of AU-C section 260 as amended by this SAS.

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**Exhibit A — Illustrations of Auditor's Reports With Emphasis-of-Matter or Other-Matter Paragraphs**

Illustration 1: An Auditor's Report With an Emphasis-of-Matter Paragraph Because There Is Uncertainty Relating to a Pending Unusually Important Litigation Matter

Illustration 2: An Auditor's Report That Includes a Key Audit Matters Section, an Emphasis-of-Matter Paragraph, and an Other-Matter Paragraph

Illustration 3: An Auditor's Report With an Other-Matter Paragraph That May Be Appropriate When an Auditor Issues an Updated Report on the Financial Statements of a Prior Period That Contains an Opinion Different From the Opinion Previously Expressed

Illustration 4: An Auditor's Report With a Qualified Opinion Due to a Material Misstatement of the Financial Statements and an Emphasis-of-Matter Paragraph Because There Is Uncertainty Relating to a Pending Unusually Important Litigation Matter

**Illustration 1: An Auditor's Report With an Emphasis-of-Matter Paragraph Because There Is Uncertainty Relating to a Pending Unusually Important Litigation Matter**

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (single year). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in AU-C section 210, *Terms of Engagement*.
- The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.
- There is uncertainty relating to a pending unusually important litigation matter.
- The auditor's report includes an emphasis-of-matter paragraph.<sup>1</sup>
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters.

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<sup>1</sup> Paragraph .A14 of this section provides guidance about the placement of an emphasis-of-matter or other-matter paragraph in the auditor's report.

## **Independent Auditor's Report**

[Appropriate Addressee]

### **Report on the Audit of the Financial Statements<sup>2</sup>**

#### ***Opinion***

We have audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects the financial position of ABC Company as of December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

#### ***Basis for Opinion***

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

#### ***Emphasis of Matter***

As discussed in Note X to the financial statements, ABC Company is a defendant in a lawsuit [*briefly describe the nature of the litigation consistent with the Company's description in the note to the financial statements*]. Our opinion is not modified with respect to this matter.

#### ***Responsibilities of Management for the Financial Statements***

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC

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<sup>2</sup> The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

### ***Auditor's Responsibilities for the Audit of the Financial Statements***

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

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>3</sup>
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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<sup>3</sup> In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

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

**Report on Other Legal and Regulatory Requirements**

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

*[Signature of the auditor's firm]*

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

*[Date of the auditor's report]*

**Illustration 2: An Auditor's Report That Includes a Key Audit Matters Section, an Emphasis-of-Matter Paragraph, and an Other-Matter Paragraph**

Circumstances include the following:

- Audit of a complete set of general purpose financial statements. The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in AU-C section 210, *Terms of Engagement*.
- The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.
- Between the date of the financial statements and the date of the auditor's report, there was a fire in the entity's production facilities, which was disclosed by the entity as a subsequent event. In the auditor's judgment, the matter is of such importance that it is fundamental to users' understanding of the financial statements. The matter did not require significant auditor attention in the audit of the financial statements in the current period.<sup>1</sup>
- The prior period financial statements were audited by a predecessor auditor.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has been engaged to communicate key audit matters.

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<sup>1</sup> Paragraph .A14 of this section provides guidance about the placement of an emphasis-of-matter or other-matter paragraph in the auditor's report.

## **Independent Auditor's Report**

*[Appropriate Addressee]*

### **Report on the Audit of the Financial Statements<sup>2</sup>**

#### ***Opinion***

We have audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

#### ***Basis for Opinion***

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

#### ***Emphasis of Matter<sup>3</sup>***

As discussed in Note X to the financial statements, subsequent to the date of the financial statements, there was a fire in ABC Company's production facilities. Our opinion is not modified with respect to this matter.

#### ***Key Audit Matters***

Key audit matters are those matters that were communicated with those charged with governance and, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

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<sup>2</sup> The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

<sup>3</sup> As noted in paragraph .A14, an emphasis-of-matter paragraph may be presented either directly before or after the "Key Audit Matters" section, based on the auditor's judgment about the relative significance of the information included in the emphasis-of-matter paragraph.

[Description of each key audit matter in accordance with section 701, Communicating Key Audit Matters in the Independent Auditor's Report, of this SAS.]

### ***Other Matter***

The financial statements of ABC Company for the year ended December 31, 20X0, were audited by another auditor, who expressed an unmodified opinion on those statements on March 31, 20X1.

### ***Responsibilities of Management for the Financial Statements***

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

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

### ***Auditor's Responsibilities for the Audit of the Financial Statements***

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

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of

expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>4</sup>

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

### **Report on Other Legal and Regulatory Requirements**

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

*[Signature of the auditor's firm]*

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

*[Date of the auditor's report]*

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<sup>4</sup> In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

**Illustration 3: An Auditor's Report With an Other-Matter Paragraph That May Be Appropriate When an Auditor Issues an Updated Report on the Financial Statements of a Prior Period That Contains an Opinion Different From the Opinion Previously Expressed**

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in AU-C section 210, *Terms of Engagement*.
- The auditor's report on the prior period financial statements expressed an adverse opinion due to identified departures from accounting principles generally accepted in the United States of America that resulted in the financial statements being materially misstated. The entity has elected to change its method of accounting for the matters that gave rise to the adverse opinion in the prior period and has restated the prior period financial statements. Therefore, the auditor has expressed an unmodified opinion on the comparative financial statements.
- The auditor's report includes an other-matter paragraph indicating that the updated report on the financial statements of the prior period contains an opinion different from the opinion previously expressed, as required by section 700 of this SAS. Although the entity changed its method of accounting for the matters that gave rise to the adverse opinion in the prior period and corrected the material misstatement in the 20X0 financial statements, the principal objective of the communication in the other-matter paragraph is to draw users' attention to the change in the auditor's opinion on the prior period financial statements. The other-matter paragraph refers to the change in accounting principle and the related disclosure in the financial statements. Therefore, the other-matter paragraph also meets the objective of communicating the change in accounting principle as required by AU-C section 708, *Consistency of Financial Statements*, and a separate emphasis-of-matter paragraph is not considered necessary.<sup>1</sup>
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in

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<sup>1</sup> Paragraph .A14 of this section provides guidance about the placement of an emphasis-of-matter or other-matter paragraph in the auditor's report

*Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*

accordance with AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.

- The auditor has not been engaged to communicate key audit matters.

## **Independent Auditor's Report**

[Appropriate Addressee]

### **Report on the Audit of the Financial Statements<sup>1</sup>**

#### ***Opinion***

We have audited the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X1 and 20X0, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

#### ***Basis for Opinion***

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

#### ***Other Matter***

In our report dated March 1, 20X1, we expressed an opinion that the 20X0 financial statements did not fairly present the financial position, results of operations, and cash flows of ABC Company in accordance with accounting principles generally accepted in the United States of America because of two departures from such principles: (1) ABC Company carried its property, plant, and equipment at appraisal values, and provided for depreciation on the basis of such values, and (2) ABC Company did not provide for deferred income taxes with respect to differences between income for financial reporting purposes and taxable income. As described in Note X, the Company has changed its method of accounting for these items and restated its 20X0 financial statements to conform with accounting principles generally accepted in the United States of America. Accordingly, our present opinion on the restated 20X0 financial statements, as presented herein, is different from that expressed in our previous report.

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<sup>1</sup> The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

### ***Responsibilities of Management for the Financial Statements***

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

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

### ***Auditor's Responsibilities for the Audit of the Financial Statements***

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

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>2</sup>

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<sup>2</sup> In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

### **Report on Other Legal and Regulatory Requirements**

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

*[Signature of the auditor's firm]*

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

*[Date of the auditor's report]*

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expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

**Illustration 4: An Auditor's Report With a Qualified Opinion Due to a Material Misstatement of the Financial Statements and an Emphasis-of-Matter Paragraph Because There Is Uncertainty Relating to a Pending Unusually Important Litigation Matter**

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (single year). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in AU-C section 210, *Terms of Engagement*.
- Inventories are misstated. The misstatement is deemed to be material but not pervasive to the financial statements.
- There is uncertainty relating to a pending unusually important litigation matter.
- The auditor's report includes a qualified opinion and also includes an emphasis-of-matter paragraph.<sup>1</sup>
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has not been engaged to communicate key audit matters.

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<sup>1</sup> Paragraph .A14 of this section provides guidance about the placement of an emphasis-of-matter or other-matter paragraph in the auditor's report.

## **Independent Auditor's Report**

[Appropriate Addressee]

### **Report on the Audit of the Financial Statements<sup>2</sup>**

#### ***Qualified Opinion***

We have audited the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

#### ***Basis for Qualified Opinion***

ABC Company has stated inventories at cost in the accompanying balance sheet. Accounting principles generally accepted in the United States of America require inventories to be stated at the lower of cost or market. If the Company stated inventories at the lower of cost or market, a write down of \$XXX would have been required as of December 31, 20X1. Accordingly, cost of sales would have been increased by \$XXX and net income, income taxes, and stockholders' equity would have been reduced by \$XXX, \$XXX, and \$XXX, as of and for the year ended December 31, 20X1, respectively.

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

#### ***Emphasis of Matter — Litigation***

As discussed in Note X to the financial statements, the Company is a defendant in a lawsuit [*briefly describe the nature of the litigation consistent with the Company's description in the note to the financial statements*]. Our opinion is not modified with respect to this matter.

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<sup>2</sup> The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

### ***Responsibilities of Management for the Financial Statements***

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

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

### ***Auditor's Responsibilities for the Audit of the Financial Statements***

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

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>3</sup>

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<sup>3</sup> In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

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

### **Report on Other Legal and Regulatory Requirements**

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

*[Signature of the auditor's firm]*

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

*[Date of the auditor's report]*

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expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.”

**.A18**

**Exhibit B — List of AU-C Sections Containing Requirements for Emphasis-of-Matter Paragraphs (Ref: par. .04)**

This exhibit identifies paragraphs in other AU-C sections in AICPA *Professional Standards* that require the auditor to include an emphasis-of-matter paragraph in the auditor's report in certain circumstances. The list is not a substitute for considering the requirements and related application and other explanatory material in specific AU-C sections.

- Paragraph .16c of section 560, *Subsequent Events and Subsequently Discovered Facts*
- Paragraphs .08–.09 and .11–.13 of section 708, *Consistency of Financial Statements*
- Paragraphs .19 and .21 of section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*

**.A19**

**Exhibit C — List of AU-C Sections Containing Requirements for Other-Matter Paragraphs (Ref: par. .04)**

This exhibit identifies paragraphs in other AU-C sections in AICPA *Professional Standards* that require the auditor to include an other-matter paragraph in the auditor's report in certain circumstances. The list is not a substitute for considering the requirements and related application and other explanatory material in specific AU-C sections.

- Paragraph .16c of section 560, *Subsequent Events and Subsequently Discovered Facts*
- Paragraphs .55–.56 and .58–.59 of section 700, *Forming an Opinion and Reporting on Financial Statements*, of this SAS
- Paragraphs 53, 92–93, 95–96, 121, and 133 of SAS *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*\*
- Paragraph .09 of section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*
- Paragraph .07 of section 730, *Required Supplementary Information*

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\* These are anticipated paragraph references from SAS *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, which is expected to be issued as a final SAS in the first half of 2019.

*Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*

- Paragraph .20 of section 800, *Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*
- Paragraph .13 of section 806, *Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements*
- Paragraph .07 of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*

*Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*