AU-C Section 705

Modifications to the Opinion in the Independent Auditor's Report

Source: SAS No. 122; SAS No. 123.

Effective for audits of financial statements for periods ending on or after December 15, 2012.

Introduction

Scope of This Section

.01 This section addresses the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with section 700, *Forming an Opinion and Reporting on Financial Statements*, the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary.

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 upon the following: (Ref: par. .A1)

- *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 professional judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements

.03 Section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*, addresses situations when the auditor considers it necessary, or is required, to include 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, 2012.

Objective

.05 The objective of the auditor is to express clearly an appropriately modified opinion on the financial statements that is necessary when

- *a.* the auditor concludes, based on the audit evidence obtained, that the financial statements as a whole are materially misstated or *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.

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 professional 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
- with regard to disclosures, are fundamental to users' understanding of the financial statements.

Requirements

Circumstances When 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–.A7)

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. .A8–.A12)

Determining the Type of Modification to the Auditor's Opinion

Qualified Opinion

.08 The auditor should express a qualified opinion when

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 or

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. .A13–.A14)

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,[1] and 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 due to a management-imposed limitation, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive, the auditor should either disclaim an opinion on the financial statements or, when practicable, withdraw from the audit.

.14 If the auditor withdraws, as contemplated by paragraph .13, before withdrawing, 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. .A15–.A16)

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.[2] To include such an unmodified opinion in the same report in these circumstances would contradict the auditor's adverse opinion or disclaimer of opinion on the financial statements as a whole. (Ref: par. .A17–.A18)

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[1] Paragraph .09 of section 260, *The Auditor's Communication With Those Charged With Governance*.

[2] Paragraph .21 of section 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*.

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. .A19)

Form and Content of the Auditor's Report When the Opinion Is Modified

Basis for Modification Paragraph

.17 When the auditor modifies the opinion on the financial statements, the auditor should, in addition to the specific elements required by section 700, include a paragraph in the auditor's report that provides a description of the matter giving rise to the modification. The auditor should place this paragraph immediately before the opinion paragraph in the auditor's report and use a heading that includes "Basis for Qualified Opinion," "Basis for Adverse Opinion," or "Basis for Disclaimer of Opinion," as appropriate. (Ref: par. .A20)

.18 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 modification paragraph 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 so state in the basis for modification paragraph. (Ref: par. .A21–.A23)

.19 If there is a material misstatement of the financial statements that relates to narrative disclosures, the auditor should include in the basis for modification paragraph an explanation of how the disclosures are misstated.

.20 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

a. discuss the omission of such information with those charged with governance;

b. describe in the basis for modification paragraph the nature of the omitted information; and

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. .A24–.A25)

.21 If the modification results from an inability to obtain sufficient appropriate audit evidence, the auditor should include in the basis for modification paragraph the reasons for that inability. (Ref: par. .A26)

.22 Even if the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements, the auditor should

a. describe in the basis for modification paragraph any other matters of which the auditor is aware that would have required a modification to the opinion and the effects thereof and (Ref: par. .A27) *b.* consider the need to describe in an emphasis-of-matter or other-matter paragraph(s)[3] any other matters of which the auditor is aware that would have resulted in additional communications in the auditor's report on the financial statements that are not modifications of the auditor's opinion.

Opinion Paragraph

.23 When the auditor modifies the audit opinion, the auditor should use a heading that includes "Qualified Opinion," "Adverse Opinion," or "Disclaimer of Opinion," as appropriate, for the opinion paragraph. (Ref: par. .A28)

.24 When the auditor expresses a qualified opinion due to a material misstatement in the financial statements, the auditor should state in the opinion paragraph that, in the auditor's opinion, except for the effects of the matter(s) described in the basis for qualified opinion paragraph, the financial statements are presented 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 matter(s) . . ." for the modified opinion. (Ref: par. .A29–.A30)

.25 When the auditor expresses an adverse opinion, the auditor should state in the opinion paragraph that, in the auditor's opinion, because of the significance of the matter(s) described in the basis for adverse opinion paragraph, the financial statements are not presented fairly in accordance with the applicable financial reporting framework.

.26 When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor should state in the opinion paragraph that

a. because of the significance of the matter(s) described in the basis for disclaimer of opinion paragraph, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion and

b. accordingly, the auditor does not express an opinion on the financial statements.

Description of the Auditor's Responsibility When the Auditor Expresses a Qualified or an Adverse Opinion

.27 When the auditor expresses a qualified or an adverse opinion, the auditor should amend the description of the auditor's responsibility to state that the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's modified audit opinion.

Description of the Auditor's Responsibility When the Auditor Disclaims an Opinion

.28 When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor should amend the introductory paragraph of the auditor's report to state that the auditor was engaged to audit the financial statements. The auditor should also amend the description of the auditor's responsibility and the description of the scope of the audit to

[3] See section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

state only the following: "Our responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with auditing standards generally accepted in the United States of America. Because of the matter(s) described in the basis for disclaimer of opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion."

Communication With Those Charged With Governance

.29 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 proposed wording of the modification. (Ref: par. .A31)

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:

	Auditor's Professional Judgment About the Pervasiveness of the Effects or Possible Effects on the Financial Statements	
Nature of Matter Giving Rise to the Modification	*Material but Not Pervasive*	*Material and Pervasive*
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

Circumstances When a Modification to the Auditor's Opinion Is Required

Nature of Material Misstatements (Ref: par. .07a)

.A2 Section 700 requires 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.[4] This conclusion takes into account the auditor's evaluation of uncorrected misstatements, if any, on the financial statements, in accordance with section 450, *Evaluation of Misstatements Identified During the Audit*.

.A3 Section 450 defines a *misstatement* as a difference between the 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

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[4] Paragraph .14 of section 700, *Forming an Opinion and Reporting on Financial Statements*.

financial reporting framework. Accordingly, a material misstatement of the financial statements may arise in relation to the following:

a. The appropriateness of the selected accounting policies

b. The application of the selected accounting policies

c. 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 With regard to the appropriateness of the accounting policies management has selected, material misstatements of the financial statements may arise when

a. the selected accounting policies are not in accordance with the applicable financial reporting framework or

b. the financial statements, including the related notes, do not represent 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 section 708, *Consistency of Financial Statements*, then a material misstatement of the financial statements may arise.

Application of the Selected Accounting Policies

.A6 With regard to the application of the selected accounting policies, material misstatements of the financial statements may arise

a. when management has not applied the selected accounting policies in accordance 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), or

b. 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 With regard to 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

a. the financial statements do not include all of the disclosures required by the applicable financial reporting framework;

b. the disclosures in the financial statements are not presented in accordance with the applicable financial reporting framework;

c. the financial statements do not provide the disclosures necessary to achieve fair presentation; or

d. 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 the information has not otherwise been disclosed in the financial statements.

Nature of an Inability to Obtain Sufficient Appropriate Audit Evidence (Ref: par. .07b)

.A8 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:

a. Circumstances beyond the control of the entity

b. Circumstances relating to the nature or timing of the auditor's work

c. Limitations imposed by management

.A9 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 requirement in paragraph .08*b* applies. 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.

.A10 Examples of circumstances beyond the control of the entity include the following:

- The entity's accounting records have been destroyed.
- The accounting records of a significant component have been seized indefinitely by governmental authorities.

.A11 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 associated entity, 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 engagement is such that the auditor is unable to observe the counting of the physical inventories, and the auditor is unable to perform a rollback of the inventory or other appropriate procedures.
- The auditor determines that performing substantive procedures alone is not sufficient, but the entity's controls are not effective.
- When accounting for long-term investments, the auditor is unable to obtain audited financial statements of an investee.

.A12 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)

.A13 Conclusive audit evidence concerning the ultimate outcome of uncertainties cannot be expected to exist at the time of the audit because the outcome and related audit evidence are prospective. In these circumstances, management is responsible for estimating the effect of future events on the financial statements or determining that a reasonable estimate cannot be made and making the required disclosures, all in accordance with the applicable financial reporting framework, based on management's analysis of existing conditions. An audit includes an assessment of whether the audit evidence is sufficient to support management's analysis. 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.

.A14 In cases involving multiple uncertainties, the auditor may conclude that it is not possible to form an opinion on the financial statements as a whole 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. .14)

.A15 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 paragraph.

.A16 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 to audit the financial statements of governmental entities. It may also be the case in circumstances when the auditor is appointed to audit the financial statements covering a specific period, or 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, respectively. In these circumstances, the auditor may also consider it necessary to include an other-matter paragraph in the auditor's report.[5]

Other Considerations Relating to a Disclaimer of Opinion (Ref: par. .15)

.A17 In an initial audit, it is acceptable for the auditor to express an unmodified opinion regarding the financial position and disclaim an opinion regarding the results of operations and cash flows, when relevant.[6] In this case, the auditor has not disclaimed an opinion on the financial statements as a whole.

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[5] Paragraph .A6 of section 706.

[6] Paragraph .A17 of section 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements*.

Considerations Specific to Audits of Governmental Entities

.A18 Because the auditor of a state and local government entity expresses an opinion or disclaims an opinion for each opinion unit,[7] 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.

Considerations Specific to Governmental Entities

.A19 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 only affects 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

Basis for Modification Paragraph (Ref: par. .17–.18, .20c, and .21–.22)

.A20 Consistency in the auditor's report helps promote users' understanding and identify unusual circumstances when they occur. Accordingly, although uniformity in the wording of a modified opinion and the description of the basis for the modification may not be possible, consistency in both the form and content of the auditor's report is desirable.

.A21 An example of the financial effects of material misstatements that the auditor may describe in the basis for modification paragraph 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 modification paragraph may be shortened by referring to it.

.A22 Adequate disclosures relate to the form, arrangement, and content of the financial statements and their 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. An auditor considers the disclosure of a particular matter in light of the circumstances and facts of which the auditor is aware at the time.

.A23 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) 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. [Revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

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[7] Paragraph .A4 of section 700.

.A24 *Practicable*, as used in the context of paragraphs .18 and .20*c*, 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 or segment information and include it in the auditor's report when management omits such information.

.A25 Disclosing the omitted information in the basis for modification paragraph would not be practicable if

a. the information has not been prepared by management or the information is otherwise not readily available to the auditor or

b. in the auditor's professional judgment, the information would be unduly voluminous in relation to the auditor's report.

.A26 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.

.A27 An adverse opinion or a disclaimer of opinion relating to a specific matter described in the basis for qualification paragraph 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.

Opinion Paragraph (Ref: par. .23–.24)

.A28 Inclusion of the paragraph heading required by paragraph .23 makes it clear to the user that the auditor's opinion is modified and indicates the type of modification.

.A29 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 paragraph 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.

.A30 When the auditor expresses a qualified opinion due to a scope limitation, paragraph .24 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.

Communication With Those Charged With Governance (Ref: par. .29)

.A31 Communicating with those charged with governance the circumstances that lead to an expected modification to the auditor's opinion and the proposed wording of the modification enables

a. the auditor to give notice to those charged with governance of the intended modification(s) and the reasons (or circumstances) for the modification(s);

b. the auditor to seek the concurrence of those charged with governance regarding the facts of the matter(s) giving rise to the expected modification(s) or to confirm matters of disagreement with management as such; and

c. those charged with governance to have an opportunity, when appropriate, to provide the auditor with further information and explanations in respect of the matter(s) giving rise to the expected modification(s).

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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

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative) prepared in accordance with accounting principles generally accepted in the United States of America.
- 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.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Financial Statements[1]

We have audited the accompanying 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.

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; 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.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. 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 financial statements are free from material misstatement.

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.[2] 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.

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[1] The subtitle "Report on the Financial Statements" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

[2] 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 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 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.

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

The 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.

Qualified Opinion

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements referred to above 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.

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—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) prepared in accordance with accounting principles generally accepted in the United States of America.
- 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.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Financial Statements[1]

We have audited the accompanying 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.

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; 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.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. 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 financial statements are free from material misstatement.

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.[2] Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and

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[1] The subtitle "Report on the Financial Statements" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

[2] 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 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 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.

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 qualified audit opinion.

Basis for Qualified Opinion

The 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.

Qualified Opinion

In our opinion, except for the omission of the information described in the Basis for Qualified Opinion paragraph, the financial statements referred to above 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.

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—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) prepared in accordance with accounting principles generally accepted in the United States of America.
- 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.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Consolidated Financial Statements[1]

We have audited the accompanying 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.

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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether 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

[1] 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.

an opinion on the effectiveness of the entity's internal control.[2] 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 adverse audit opinion.

Basis for Adverse Opinion

As described in Note X, the 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.

Adverse Opinion

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion paragraph, the consolidated financial statements referred to above 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.

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*]

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[2] 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.

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) prepared in accordance with accounting principles generally accepted in the United States of America.
- 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.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Financial Statements[1]

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.

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; 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.

Auditor's Responsibility

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. 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 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.[2] Accordingly, we express no such opinion. An audit

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[1] The subtitle "Report on the Financial Statements" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

[2] 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 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 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.

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 qualified audit opinion.

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.

Qualified Opinion

In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion paragraph, 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 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 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) prepared in accordance with accounting principles generally accepted in the United States of America.
- 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.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Financial Statements[1]

We were engaged to audit 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.

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; 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.

Auditor's Responsibility

Our responsibility is to 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. Because of the matter described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

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[1] The subtitle "Report on the Financial Statements" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

Basis for Disclaimer of Opinion

The 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.

Disclaimer of Opinion

Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on these financial statements.

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 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) prepared in accordance with accounting principles generally accepted in the United States of America.
- 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. 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.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Financial Statements[1]

We were engaged to audit 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.

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; 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.

Auditor's Responsibility

Our responsibility is to 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. Because of the matters described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

We were not engaged as auditors of the 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

[1] The subtitle "Report on the Financial Statements" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

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.

Disclaimer of Opinion

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on these financial statements.

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 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) prepared in accordance with accounting principles generally accepted in the United States of America.
- 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.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Financial Statements[1]

We have audited the accompanying 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.

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; 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.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. 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 financial statements are free from material misstatement.

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.[2] Accordingly, we express no such opinion. An audit

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[1] The subtitle "Report on the Financial Statements" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

[2] 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 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 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.

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 qualified audit opinion.

Basis for Qualified Opinion

The Company has excluded, from property and debt in the accompanying 20X1 balance sheet, certain lease obligations that were entered into in 20X1 which, 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.

Qualified Opinion

In our opinion, except for the effects on the 20X1 financial statements of not capitalizing certain lease obligations as described in the Basis for Qualified Opinion paragraph, the financial statements referred to above 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.

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 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) prepared in accordance with accounting principles generally accepted in the United States of America.
- The auditor was unable to observe the physical inventory as at December 31, 20X0, as 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.
- The auditor expressed an unmodified opinion on December 31, 20X1 and 20X0 balance sheets and a disclaimer of opinion on the 20X0 statements of income, changes in stockholders' equity, and cash flows.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Financial Statements[1]

We have audited the accompanying 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.

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; 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.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. Except as explained in the Basis for Disclaimer of Opinion paragraph, 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 financial statements are free from material misstatement.

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

[1] The subtitle "Report on the Financial Statements" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

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.[2] 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 audit opinions 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.

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, since that date was prior to our engagement as auditors for the 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.

Disclaimer of Opinion on 20X1 Operations and Cash Flows

Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion 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

In our opinion, the 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.

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*]

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[2] 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 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 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.