AU-C Section 700

Forming an Opinion and Reporting on Financial Statements

(Supersedes SAS No. 122 section 700; SAS No. 131.)

Source: SAS No. 134; SAS No. 137.

Effective for audits of financial statements for periods ending on or after December 15, 2020.

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, section 703, 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, 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, addresses the auditor's responsibility to communicate key audit matters when the auditor is engaged to do so.

.06 Section 800, Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks, addresses special considerations when financial statements are prepared in accordance with a special purpose framework. 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. (Ref: par. .A1–.A2)

1 See section 800, Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks, for a definition of special purpose framework.
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

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

Objectives

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

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

Comparative financial statements. A complete set of financial statements\(^2\) 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\(^3\) 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.

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.

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\(^2\) See 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.

\(^3\) Paragraph .14 of section 200 defines the term *historical financial information*. 
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.4

.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 assurance5 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 section 330, Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained, about whether sufficient appropriate audit evidence has been obtained6

b. The auditor's conclusion, in accordance with section 450, Evaluation of Misstatements Identified During the Audit, about whether uncorrected misstatements are material, individually or in the aggregate7

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 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.

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4 Paragraph .14 of section 200 defines the term applicable financial reporting framework.
5 Paragraph .14 of section 200 defines the term reasonable assurance.
6 Paragraph .28 of section 330, Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained.
7 Paragraph .11 of section 450, Evaluation of Misstatements Identified during the Audit.
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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, 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. (Ref: par. .A21–.A22)

Auditor’s Report

.21 The auditor's report should be in writing. (Ref: par. .A23–.A24)
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**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 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. (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.8 (Ref: par. .A46)

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8 Paragraph .02 of section 320, Materiality in Planning and Performing an Audit.
.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 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 When applicable, the auditor should report in accordance with section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports. [Paragraph added, effective for audits of financial statements for periods ending on or after December 15, 2020, by SAS No. 137.]

.39 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) [Paragraph renumbered, effective for audits of financial statements for periods ending on or after December 15, 2020, by SAS No. 137.]

.40 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
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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) [Paragraph renumbered, effective for audits of financial statements for periods ending on or after December 15, 2020, by SAS No. 137.]

Signature of the Auditor

.41 The auditor's report should include the manual or printed signature of the auditor's firm. (Ref: par. .A50–.A52) [Paragraph renumbered, effective for audits of financial statements for periods ending on or after December 15, 2020, by SAS No. 137.]

Auditor's Address

.42 The auditor's report should name the city and state where the auditor's report is issued. (Ref: par. .A53) [Paragraph renumbered, effective for audits of financial statements for periods ending on or after December 15, 2020, by SAS No. 137.]

Date of the Auditor's Report

.43 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)

[Paragraph renumbered, effective for audits of financial statements for periods ending on or after December 15, 2020, by SAS No. 137.]

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

.44 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) [Paragraph renumbered, effective for audits of financial statements for periods ending on or after December 15, 2020, by SAS No. 137.]

.45 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.

[Paragraph renumbered, effective for audits of financial statements for periods ending on or after December 15, 2020, by SAS No. 137.]

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

.46 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
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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) [Paragraph renumbered, effective for audits of financial statements for periods ending on or after December 15, 2020, by SAS No. 137.]

Comparative Financial Statements and Comparative Information

.47 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) [Paragraph renumbered, effective for audits of financial statements for periods ending on or after December 15, 2020, by SAS No. 137.]

.48 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) [Paragraph renumbered, effective for audits of financial statements for periods ending on or after December 15, 2020, by SAS No. 137.]

.49 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) [Paragraph renumbered, effective for audits of financial statements for periods ending on or after December 15, 2020, by SAS No. 137.]

.50 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) [Paragraph renumbered, effective for audits of financial statements for periods ending on or after December 15, 2020, by SAS No. 137.]

Audit Procedures

.51 The auditor should perform the procedures required by paragraphs .51–.53 if comparative financial statements or comparative information is presented for the prior periods. [Paragraph renumbered, effective for audits of financial statements for periods ending on or after December 15, 2020, by SAS No. 137.]

.52 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. [Paragraph renumbered, effective for audits of financial statements for periods ending on or after December 15, 2020, by SAS No. 137.]

.53 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
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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

[Paragraph renumbered, effective for audits of financial statements for periods ending on or after December 15, 2020, by SAS No. 137.]

.54 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 section 560, Subsequent Events and Subsequently Discovered Facts. If the prior period financial statements are restated, the auditor should determine that the comparative financial statements or comparative information agrees with the restated financial statements. [Paragraph renumbered, effective for audits of financial statements for periods ending on or after December 15, 2020, by SAS No. 137.]

.55 As required by 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) [Paragraph renumbered, effective for audits of financial statements for periods ending on or after December 15, 2020, by SAS No. 137.]

.56 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:

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)

[Paragraph renumbered, effective for audits of financial statements for periods ending on or after December 15, 2020, by SAS No. 137.]

Prior Period Financial Statements Audited by a Predecessor Auditor

.57 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, in addition to expressing an opinion on the

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9 See section 708, Consistency of Financial Statements.
10 Paragraphs .19–.20 of section 560, Subsequent Events and Subsequently Discovered Facts.
current period's financial statements, the auditor should state the following in an other-matter paragraph:\(^{11}\)

\[\text{a. That the financial statements of the prior period were audited by a predecessor auditor} \]

\[\text{b. The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefore} \]

\[\text{c. The nature of an emphasis-of-matter paragraph or other-matter paragraph included in the predecessor auditor's report, if any} \]

\[\text{d. The date of that report} \]

[Paragraph renumbered, effective for audits of financial statements for periods ending on or after December 15, 2020, by SAS No. 137.]

.58 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 section 510, Opening Balances — Initial Audit Engagements, Including Reaudit Engagements.\(^{12}\) 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) [Paragraph renumbered, effective for audits of financial statements for periods ending on or after December 15, 2020, by SAS No. 137.]

**Prior Period Financial Statements Not Audited**

.59 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\(^{13}\) in the current period auditor's report that includes the following with respect to the prior period:

\[\text{a. The service performed in the prior period} \]

\[\text{b. The date of the report on that service} \]

\[\text{c. A description of any material modifications noted in that report} \]

\[\text{d. For a review engagement, a statement that the service was substantially less in scope than an audit and does not provide the basis for the expression of an opinion on the financial statements as a whole (Ref: par. .A76)} \]

\[\text{e. For a compilation engagement, a statement that no opinion or other form of assurance is expressed on the financial statements (Ref: par. .A77)} \]

[Paragraph renumbered, effective for audits of financial statements for periods ending on or after December 15, 2020, by SAS No. 137.]

.60 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

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\(^{11}\) See section 706, Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor’s Report,.

\(^{12}\) Paragraphs .12–.13 of section 510, Opening Balances — Initial Audit Engagements, Including Reaudit Engagements.

\(^{13}\) See section 706.
indicate that the auditor has not audited, reviewed, or compiled the prior per-
period financial statements and that the auditor assumes no responsibility for 
them. (Ref: par. .A78) [Paragraph renumbered, effective for audits of financial 
statements for periods ending on or after December 15, 2020, by SAS No. 137.]

Information Presented in the Financial Statements

.61 Information that is not required by the applicable financial reporting 
framework but is nevertheless presented as part of the basic financial state-
ments should be covered by the auditor's opinion if it cannot be clearly differ-
entiated. (Ref: par. .A79–.A80) [Paragraph renumbered, effective for audits of 
financial statements for periods ending on or after December 15, 2020, by SAS 
No. 137.]

Application and Other Explanatory Material

Scope of This Section (Ref par. .06)

.A1 Section 800 also addresses the auditor's responsibilities when the au-
ditor is reporting on financial statements prepared in accordance with a special 
purpose framework and is required by law or regulation to use a specific lay-
out, form, or wording of the auditor's report. When reporting on financial state-
ments 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:

- Section 510, Opening Balances—Initial Audit Engagements, In-
  cluding Reaudit Engagements
- Section 570, The Auditor's Consideration of an Entity's Ability to 
  Continue as a Going Concern
- Section 720, The Auditor's Responsibilities Relating to Other In-
  formation Included in Annual Reports
- Section 725, Supplementary Information in Relation to the Finan-
  cial Statements as a Whole
- Section 730, Required Supplementary Information
- Section 810, Engagements to Report on Summary Financial State-
  ments
- Section 910, Financial Statements Prepared in Accordance With 
  a Financial Reporting Framework Generally Accepted in Another 
  Country

[As amended, effective for audits of financial statements for periods ending on 
or after December 15, 2020, by SAS No. 137.]

Objectives

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

.A3 For audits of governmental entities, the objectives of a financial state-
ment 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 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 Section 260, The Auditor’s Communication With Those Charged With Governance, contains a discussion of the qualitative aspects of accounting practices. 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 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,

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14 The appendix "Qualitative Aspects of Accounting Practices" of section 260, The Auditor's Communication With Those Charged With Governance.
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:

- 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 section 200, a fair presentation financial reporting framework\(^{15}\) 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.\(^{16}\)

.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 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.\(^{17}\) 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 statements comply with all the requirements of that

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\(^{15}\) Paragraph .14 of section 200.

\(^{16}\) See section 320.

\(^{17}\) Paragraphs .A2–.A3 of section 200.
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) 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)

.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 Section 200 provides guidance on reporting when the auditor is not
independent.\footnote{Paragraph \A18 of section 200.}

*Addressee (Ref: par. .23)*

.\A26 The auditor's report is normally addressed to those for whom the re-
port 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 propri-
etor). 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 finan-
cial 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 stock-
holders' equity, and cash flows for the year then ended, and the related notes to
the financial statements." If the financial statements include a separate state-
ment of changes in stockholders' equity accounts or a separate statement of
comprehensive income, paragraph .25c requires such statements to be identi-
fied in the "Opinion" section, but they need not be referred to separately in the
opinion paragraph because changes in stockholders' equity accounts and com-
prehensive 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.

.\A29 When the auditor is aware that the audited financial statements will
be included in a document that contains information in addition to the finan-
cial statements and the auditor's report thereon, the auditor may consider, if
the form of presentation allows, identifying the page numbers on which the au-
dited 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 appro-
priate 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 weak-
ening 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 section 200, the auditor does not represent compliance with GAAS in the auditor's report unless the auditor has complied with the requirements of section 200 and all other AU-C sections relevant to the audit.19

.A38 *Relevant Ethical Requirements (Ref: par. .28c).* 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.20 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. Section 600, *Special Considerations — Audits of Group*

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19 Paragraph .22 of section 200.
20 Paragraph .A15 of section 200.
Forming an Opinion and Reporting on Financial Statements

Financial Statements (Including the Work of Component Auditors), 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 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.

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

.A41 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. 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 report includes reference to both of these responsibilities because it helps explain to users the premise on which an audit is conducted. 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.

.A44 Objectives of the Auditor (Ref: par. .35a–c). The auditor's report explains that the objectives of the auditor are to obtain reasonable assurance

21 Paragraphs .22–.23 of section 600, Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors).
22 Paragraph .10 of section 210, Terms of Engagement.
23 Paragraphs .05 and .A2 of section 200.
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.24

.A46 When the applicable financial reporting framework defines materiality differently from the definition in 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.

*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.25 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 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.

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24 Paragraph .A56 of section 200 and paragraph .10d of section 210.

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)**

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)**

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, 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.26 When an engagement quality control review is performed, section 220 requires that the auditor’s report not be released prior to the completion of the engagement quality control review.27

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 section 560.

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**

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)**

If the audit is performed in accordance with both GAAS and the ISAs, the auditor may find it helpful to refer to 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.

26 See paragraph .19 of section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, for further discussion.

27 Paragraph .21 of section 220.
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 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.28

.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.29

.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

28 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.

29 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 PCAOB Standards and Related Rules.
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.

.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.30 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 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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30 See section 560, Subsequent Events and Subsequently Discovered Facts.
Audit Conclusions and Reporting

.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 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.\(^{31,32}\) The exhibit to this section provides examples of auditor's reports when comparative summarized financial information for the prior period is presented.\(^{33}\)

.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.

**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.\(^{34}\)

**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\(^ {35}\) 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 to audit the adjustments and obtains sufficient appropriate audit evidence to be satisfied about the appropriateness of

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\(^{31}\) Paragraph .33 of section 930, *Interim Financial Information*.

\(^{32}\) 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.


\(^{34}\) See section 560.

\(^{35}\) See section 706.
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)

.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."

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 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 Non-registered 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 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 section 570, The Auditor's Consideration of an Entity’s Ability to Continue as a Going Concern.

• The auditor has obtained all the other information prior to the date of the auditor's report and has not identified an uncorrected material misstatement of the other information included in the annual report.

• 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

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

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1 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.
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].

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.\(^2\)
- 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

\(^2\) 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.”
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.

**Other Information (or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor’s Report Thereon")**

[Reporting in accordance with the reporting requirements in section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports (refer to illustration 1, "The Auditor Has Not Identified an Uncorrected Material Misstatement of the Other Information," in the exhibit of section 720)]

**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 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 section 570, The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern.

• The auditor has obtained all the other information prior to the date of the auditor's report and has not identified an uncorrected material misstatement of the other information included in the annual report.

• The auditor has been engaged to communicate key audit matters.

Independent Auditor’s Report

[Appropriate Addressee]

Report on the Audit of the Financial Statements

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

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3 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.
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,]*

**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.4

- 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.

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor’s Report Thereon"]

[Reporting in accordance with the reporting requirements in section 720, The Auditor’s Responsibilities Relating to Other Information Included in Annual Reports (refer to illustration 1, "The Auditor Has Not Identified an Uncorrected Material Misstatement of the Other Information, " in the exhibit of section 720)]

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]

4 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 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 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 section 570, The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern.
- The auditor has obtained all the other information prior to the date of the auditor's report and has not identified an uncorrected material misstatement of the other information included in the annual report.
- 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

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

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5 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.
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].

**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.6
- 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

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6 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.”
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.

Other Information (or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon")

[Reporting in accordance with the reporting requirements in section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports (see illustration 1, "The Auditor Has Not Identified an Uncorrected Material Misstatement of the Other Information," in the exhibit of section 720)]

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]
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). 

- The terms of the audit engagement reflect the description of management’s responsibility for the financial statements in 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 section 570, The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern.

- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.

- The auditor has obtained all the other information prior to the date of the auditor's report and has not identified an uncorrected material misstatement of the other information included in the annual report.

- The auditor has not been engaged to communicate key audit matters.

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7 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).
Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Financial Statements\(^8\)

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 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...
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.\(^9\)
- 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.\(^10\)

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.

**Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]**

[Reporting in accordance with the reporting requirements in section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports (see illustration 1, "The Auditor Has Not Identified an Uncorrected Material Misstatement of the Other Information," in the exhibit of section 720)]

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\(^9\) 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."

\(^10\) This has been included to comply with paragraph 50(k) of ISA 700 (Revised).
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]

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 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 section 570, The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern.
- The auditor has obtained all the other information prior to the date of the auditor’s report and has not identified an uncorrected material misstatement of the other information included in the annual report.
- 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\(^{11}\)

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.

\(^{11}\) 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 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-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.12

12 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.”
Audit Conclusions and Reporting

- 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 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.

**Other Information**

[Reporting in accordance with the reporting requirements in section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports (see illustration 1, "The Auditor Has Not Identified an Uncorrected Material Misstatement of the Other Information," in the exhibit of section 720)]

**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]

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 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 section 570, The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern.
- The auditor has obtained all the other information prior to the date of the auditor’s report and has not identified an uncorrected material misstatement of the other information included in the annual report.
- 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

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.

13 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 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-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.14

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14 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."
• 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 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.

**Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]**

[Reporting in accordance with the reporting requirements in section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports (see illustration 1, "The Auditor Has Not Identified an Uncorrected Material Misstatement of the Other Information," in the exhibit of section 720)]

**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]15

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.

15 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 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.

All AS sections can be found in PCAOB Standards and Related Rules.
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, 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.16

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 committee17 and that: (1) relate to accounts or disclosures that are material to the financial statements and (2)

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16 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.

17 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.
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]

[Signature]

We have served as the Company's auditor since [year].

[City and State or Country]

[Date]

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18 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] 19

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

19 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 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.
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, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.20

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 committee21 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

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20 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.

21 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.
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]

[Signature]

We have served as the Company's auditor since [year].22

[City and State or Country]

[Date]

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2020, by SAS No. 137.]

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22 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.

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

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 strikethrough.)

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

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 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 section 200.]

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.5 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.

5 [Footnote omitted for the purposes of this section.]
* [Footnote omitted for the purposes of this section.]

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

Audit Engagement Letter or Other Form of Written Agreement10 (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.11 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 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,\(^{12}\) 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 their signature on the engagement letter

\(^{10}\) [Footnote omitted for purposes of this section.]

\(^{11}\) [Footnote omitted for purposes of this section.]

\(^{12}\) _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. ..A25.A26)
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:

[The objective and scope of the audit]

You 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 expression of 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 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. 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 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.

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 acknowledge and understand that they have responsibility

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]

1 [Footnote omitted for purposes of this section.]

2 [Footnote omitted for purposes of this section.]

3 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.

24 [Footnote omitted for purposes of this section.]

[All subsequent footnotes are renumbered.]

[No further amendments to section 210.]

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;
Audit Conclusions and Reporting

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–A31)

[No amendments to paragraphs .23–.27.]

A28 When section 701, Communicating Key Audit Matters in the Independent Auditor's Report, 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, 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 section 220.]

Section 230, Audit Documentation

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

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, applies, the auditor's determination of the key audit matters or the determination that

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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. 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
Paragraph .13 of section 915, *Reports on Application of Requirements of an Applicable Financial Reporting Framework*

Paragraphs .42–.43 of section 930, *Interim Financial Information*

Paragraphs .39–.42 of section 935, *Compliance Audits*

[No further amendments to section 230.]

**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. 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)

...  

[Footnote omitted for the purposes of this section.]  

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

**Characteristics of Fraud (Ref: par. .03)**

.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 section 240.]

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–A22–A24)

Significant Findings or Issues From the Audit

NOTE
Paragraph .12 is subsequently amended by SAS No. 135, Amendments to Various Sections in SAS No. 122, Statements on Auditing Standards: Clarification and Recodification, as Amended, and to SAS No. 130, An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements. See appendix B for those amendments.

.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–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. 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. A31.A39)

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. A32.A40)

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. A33.A41)

[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, providing 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 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, 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.**

4 The "Breach of an Independence Interpretation" interpretation (ET sec. 1.298.010), 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.**

**.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 expert.\(^5\)

- **When section 701,** Communicating Key Audit Matters in the Independent Auditor's Report, **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.

\(^5\) 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:
Audit Conclusions and Reporting

— 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.

Care is required 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 may be relevant in determining the nature and extent of this communication.

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

When section 701, Communicating Key Audit Matters in the Independent Auditor's Report, 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.6

Paragraphs .08-.09 of section 701, Communicating Key Audit Matters in the Independent Auditor's Report.

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

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.

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)

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)

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. 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. 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.

Paragraph .09 of section 210, Terms of Engagement.

Paragraph .10 of section 210.

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.\(^{10}\)
- 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.\(^{11}\)
- Key audit matters are communicated in accordance with section 701, Communicating Key Audit Matters in the Independent Auditor's Report.\(^{12}\)
- 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,\(^{13}\) 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.

\(^{10}\) Paragraph .31 of section 705, Modifications to the Opinion in the Independent Auditor's Report.

\(^{11}\) Paragraphs .24 and .28 of section 570, The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern.

\(^{12}\) Paragraph .16 of section 701, Communicating Key Audit Matters in the Independent Auditor's Report.


Other Findings or Issues

\(-A27A34\) 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


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)

\(.A35\) Section 300, Planning an Audit,\(^{14}\) 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.

14 Paragraph .A15 of Section 300, Planning an Audit.

.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.15

15 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)

.A32 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.]

.A48 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, 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,\(^16\)

- When section 706, Communicating Key Audit Matters in the Independent Auditor's Report, applies, the matters planned to be included in the auditor’s report

\(^{16}\) Paragraph .31 of section 705, Modifications to the Opinion in the Independent Auditor's Report.

[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 .4928 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

k. paragraphs .12, .14, .29.24, and .29.31 of section 705, Modifications to the Opinion in the Independent Auditor's Report


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AU-C §700.A82
Audit Conclusions and Reporting

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 expert 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


[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

...
• 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*

• 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
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 au-
ditor 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)**
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.

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 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.]

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

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 experts 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

14 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.

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 likely to be less sophisticated than in larger entities, but their 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.

Componentsof Internal Control—Control Activities (Ref: par. .21)

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.

Identifying and Assessing the Risks of Material Misstatement

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

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.

The Use of Assertions

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.]

.A132 The auditor may use the assertions as described above 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

Assertions used by the auditor 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 have been included in the financial statements at appropriate amounts, and any resulting valuation or allocation adjustments 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.

c. 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 200.5

5 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 320,6 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.\(^7\)

\(^6\) Paragraph .A1 of section 320.

\(^7\) 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)

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
- 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
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- 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)

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 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.\(^1\) 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.\(^2\) (Ref: par. .A1)

\(^1\) See paragraphs .A141–.A142 of section 315, Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement.

\(^2\) [Footnote omitted for purposes of this section.]

[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 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.)

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

[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 .22–.25.]

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 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.
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.**

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

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.

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

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**, the classification of items in the statements, **aggregation and disaggregation of amounts**, and the bases of amounts set forth.

Section 450, Evaluation of Misstatements Identified During the Audit

Definitions

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,
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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 judgments of management concerning accounting estimates that the auditor considers unreasonable or the selection or application of accounting policies that the auditor considers inappropriate;
e. an inappropriate classification, aggregation, or disaggregation of information; and
f. 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. 5

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.

.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.6

6 [Footnote omitted for purposes of this section.]

[Paragraphs .A4–.A5 are renumbered .A7–.A8. The content is unchanged.]

**Communication and Correction of Misstatements (Ref: par. .07–.09)**

.A8 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 misstated, 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.
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, or paragraph .A70 of section 703, Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA, 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.

.16 Paragraph .16 of section 700, Forming an Opinion and Reporting on Financial Statements.
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.

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. 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.

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.

Section 510, Opening Balances—Initial Audit Engagements, Including Reaudit Engagements

[No amendments to paragraphs .01–.A17.]

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.

[Paragraph .A18 is renumbered as paragraph .A19. The content is unchanged.]


.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.¹
- 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.

¹ [Footnote omitted for purposes of this section.]

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Financial Statements²

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 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

2 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, 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. 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. 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
form an opinion and reporting on financial statements

3 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.]
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 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, or the auditor may consider it necessary to include by adding an emphasis-of-matter paragraph to the auditor’s report (see section 706, Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor’s Report), addresses the use of such paragraphs. If the matter is determined to be a key audit matter, section 706 prohibits the auditor from including that matter in an emphasis-of-matter paragraph in the auditor’s report.

[No further amendments to section 540.]

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 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

Report on the Audit of the Consolidated Financial Statements

1 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 gen-
erally accepted in the United States of America (GAAS). Our respon-
sibilities 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 sub-
sidaries 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 rele-
vant 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 re-
quired to evaluate whether there are conditions or events, considered in
the aggregate, that raise substantial doubt about ABC Company's abil-
ity 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 guar-
antee 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 re-
sulting from error, as fraud may involve collusion, forgery, intentional
omissions, misrepresentations, or the override of internal control. Mis-
statements 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 appropri-
  ate in the circumstances, but not for the purpose of express-
  ing an opinion on the effectiveness of ABC Company's inter-
  nal control. Accordingly, no such opinion is expressed.²
• 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.

2 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

We have audited the accompanying consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance

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.
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 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. 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 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]


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

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Audit Conclusions and Reporting

1 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.  
- 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.

2 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/

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

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

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.

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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. 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]


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.

**Independent Auditor’s Report**

[Appropriate Addressee]

Report on the Audit of the Consolidated Financial Statements

1 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.

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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.
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.\(^2\)
- 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.

\(^2\) 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/

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

Report on the Consolidated Financial Statements

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 these 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 the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the

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.
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. 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]


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

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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.
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.  
- 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.

2 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./
Audit Conclusions and Reporting


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

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 19 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. 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

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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.
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. 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

[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]

[Date of the auditor's report]

[No further amendments to section 600.]

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

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.
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 these financial statements in accordance with [specify the financial reporting framework generally accepted] in [name of country], and for ensuring that the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements 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.1]

1 Paragraph .32b of section 700, Forming an Opinion and Reporting on Financial Statements.

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 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 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]

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 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.]

1 Paragraph .32b of section 700, Forming an Opinion and Reporting on 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.

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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.

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—with the heading "Substantial Doubt About the Entity's Ability to Continue as a Going Concern" that does the following: (Ref: par. .A51–.A54, A57)

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

* 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 terms consistent with those included in the applicable financial reporting framework. In a going concern emphasis of matter paragraph, 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.

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 "Going Concern" 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 "Going Concern" 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.

c. Considering the matters described in paragraphs .16–.18 of this section based on the conditions or circumstances at the date of reissuance
Considering the implications for the auditor's report in accordance with section 560\(^\text{97}\) (Ref: par. .A61–.A62–.A63)

Paragraphs .09–.11 of section 560, Subsequent Events and Subsequently Discovered Facts.

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

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.

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.

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.

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

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, making reference to management's disclosures related to the conditions and events and management's plans related to those conditions and events.

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.

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, 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, applies.

b. The auditor would be required to modify the opinion in accordance with section 705 as a result of the matter.

38 Paragraph .08 of section 706.

.56 As indicated in section 705, 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.

39 Paragraph .07 of section 705, Modifications to the Opinion in the Independent Auditor's Report.

Inappropriate Use of Conditional Language

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)

After the auditor has issued the auditor's report containing a "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 "Going Concern" emphasis-of-matter paragraph 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)

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. 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.

**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.
Appendix B—Amendments to Various Sections in SAS No. 122, Statements on Auditing Standards: Clarification and Recodification, as Amended, and to SAS No. 130, An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements

(Boldface italic denotes new language. Deleted text is in strikethrough.)

SAS No. 122, Section 260, The Auditor’s Communication With Those Charged With Governance

1. Section 260 addresses the auditor’s responsibility to communicate with those charged with governance in an audit of financial statements. This amendment adds material from PCAOB AS 1301, Communications with Audit Committees,¹ that the ASB believes will enhance the quality of audits of financial statements of non-issuers. Additional communications about the auditor’s views relating to the entity’s significant unusual transactions, and about the potential effects of uncorrected misstatements on future-period financial statements are required. Application material provides guidance about communicating the possible implications of uncorrected misstatements and complaints or concerns about accounting or auditing matters that have come to the auditor’s attention. Additionally, application material is provided addressing documentation when management has communicated some or all of the matters the auditor is required to communicate with those charged with governance.

[No amendment to paragraphs .01–.11.]

NOTE
Paragraph .12 is previously amended by SAS No. 134, Amendments to Various Sections in SAS No. 122, Statements on Auditing Standards: Clarification and Recodification, as Amended, and to SAS No. 132, The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern. See appendix A for those amendments.

.12 The auditor should communicate with those charged with governance: (Ref: par. .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. .A27–.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.

¹ All AS sections can be found in PCAOB Standards and Related Rules.
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 unusual transactions, if any. (Ref: par. A30)

bc. Significant difficulties, if any, encountered during the audit. (Ref: par. A30A31)

dc. Disagreements with management, if any. (Ref: par. A31A32)

de. Circumstances that affect the form and content of the auditor's report, if any. (Ref: par. A32A33–A33A34)

f. Matters that are difficult or contentious for which the auditor consulted outside the engagement team and 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.

g. Other findings or issues, if any, arising 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. A34A35–A36A37)

Uncorrected Misstatements

.13 The auditor should communicate with those charged with governance: (Ref: par. A37–A38A38–A39)

a. uncorrected misstatements accumulated by the auditor and the effect that they, individually or in the aggregate, may have on the opinion in the auditor's report. The auditor's communication should identify material uncorrected misstatements individually. The auditor should request that uncorrected misstatements be corrected.

b. the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

c. that uncorrected misstatements or matters underlying those uncorrected misstatements could potentially cause future-period financial statements to be materially misstated, even if the auditor has concluded that the uncorrected misstatements are immaterial to the financial statements under audit.

[No amendment to paragraphs .14–.15.]

Forms of Communication

.17 If, as part of its communication to those charged with governance, management communicated some or all of the matters the auditor is required to communicate, and as a result, the auditor did not communicate these matters at the same level of detail as management, the auditor should communicate any omitted or inadequately described matters to those charged with governance. The auditor does not need to communicate them at the same level of detail as management, as long as the auditor a) participated in management's discussion with those charged with governance, and b) affirmatively confirmed to those
charged with governance that management has adequately communicated these matters.

[Paragraphs .17–.19 are renumbered as .18–.20. The content is unchanged.]

Documentation

2021 When matters required to be communicated by this section have been communicated orally, the auditor should include them in the audit documentation, including when and to whom they were communicated. When matters have been communicated in writing, the auditor should retain a copy of the communication as part of the audit documentation. If, as part of its communication to those charged with governance, management communicated some or all of the matters the auditor is required to communicate, and as a result, the auditor did not communicate these matters at the same level of detail as management, the auditor should include a copy or summary of management’s communications provided to those charged with governance in the audit documentation. (Ref: par. A47–A48)

2 Paragraphs .08–.12 and A8 of section 230, Audit Documentation.

[No amendment to paragraphs .A1–.A29.]

Significant Unusual Transactions (Ref: par. .12b)

.A30 The communication of significant unusual transactions may include

- the auditor’s views on the policies and practices management used to account for significant unusual transactions; and
- the auditor’s understanding of the business purpose for significant unusual transactions.

[Paragraphs .A30–.A57 are renumbered as .A31–.A58. The content is unchanged.]

2. This amendment is effective for audits of financial statements for periods ending on or after December 15, 2020.

SAS No. 122, Section 550, Related Parties

3. Section 550 addresses the auditor’s responsibility relating to related party relationships and transactions in an audit of financial statements. This amendment adds material from PCAOB AS 2410, Related Parties, that the ASB believes will enhance the quality of audits of financial statements of non-issuers. The amendment adds or amends requirements and application material to heighten the auditor’s focus on related parties relationships and transactions. The amendment accomplishes the following:

- Enhance requirements to identify previously unidentified or undisclosed related parties or significant related party transactions.
- Enhance the auditor's response to the risks of material misstatement associated with related party relationships and transactions, including procedures to test the accuracy and completeness of the related party relationships and transactions identified by the entity, taking into account the information gathered during the audit.
- Provide application material regarding the enhanced requirements, as well as additional examples of significant related party findings and issues that may be communicated to those charged with governance.
.01 This section addresses the auditor’s responsibilities relating to related party relationships and transactions in an audit of financial statements.1 Specifically, it expands on how section 315, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement; section 330, Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained; and section 240, Consideration of Fraud in a Financial Statement Audit, are to be applied regarding risks of material misstatement associated with related party relationships and transactions.

1 The phrase "related party relationships and transactions" as used in generally accepted auditing standards is intended to have the same meaning as the phrase "related parties and relationships and transactions with related parties" as used in the auditing standards of the PCAOB.

[Subsequent footnotes are renumbered.]

[No amendment to paragraphs .02–.13.]

.14 The auditor should inquire of management and others within the entity regarding the following:

a. The identity of the entity’s related parties, including changes from the prior period (Ref: par. .A9–A415)

b. The nature of the relationships (including ownership structure) between the entity and these related parties

- The business purpose of entering into a transaction with a related party versus an unrelated party

d. Whether the entity entered into, modified, or terminated any transactions with these related parties during the period and, if so, the type and business purpose of the transactions

.15 The auditor should inquire of management and others within the entity and perform other risk assessment procedures11 considered appropriate to obtain an understanding of the controls, if any, that management has established to (Ref: par. .A15–A20,A16–A21)

a. identify, account for, and disclose related party relationships and transactions.

b. authorize and approve significant transactions and arrangements with related parties. (Ref: par. A21A22)

c. authorize and approve significant unusual transactions, and arrangements outside the normal course of business.

Inquiries should include asking about any related party transactions

a. that have not been authorized and approved in accordance with the entity’s established policies or procedures regarding the authorization and approval of transactions with related parties.

b. for which exceptions to the entity’s established policies or procedures were granted and the reasons for granting those exceptions. (Ref: par. A44–A45)

11 [Footnote omitted for purposes of this section.]

.16 Unless all of those charged with governance are involved in managing the entity, the auditor should inquire of those charged with governance (or the audit committee or, at least, its chair) regarding
a. their understanding of the entity’s relationships and transactions with related parties that are significant to the entity and

b. whether any of those charged with governance have concerns regarding relationships or transactions with related parties and, if so, the substance of those concerns.

Remaining Alert Maintaining Alertness for Related Party Information When Reviewing Records or Documents

.1617 During the audit, the auditor should remain alert when inspecting records or documents for arrangements or other information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor. In particular, the auditor should inspect the following for indications of the existence of related party relationships or transactions that management has not previously identified or disclosed to the auditor: (Ref: par. .A22–.A24 .A23–.A25)

a. Bank and legal confirmations obtained as part of the auditor’s procedures

b. Minutes of meetings of shareholders and of those charged with governance and summaries of actions of recent meetings for which minutes have not yet been prepared

c. Such other records or documents as the auditor considers necessary in the circumstances of the entity

.17.18 If the auditor identifies significant unusual transactions outside the entity’s normal course of business when performing the audit procedures required by paragraph .17 or through other audit procedures, the auditor should inquire of management about the following: (Ref: par. .A25–.A26 .A26–.A27)

a. The nature of these transactions (Ref: par. .A27–.A28)

b. Whether related parties could be involved (Ref: par. .A28–.A29)

[Paragraph .18 is renumbered as paragraph .19. The content is unchanged.]

.19.20 In meeting the requirement of section 315 to identify and assess the risks of material misstatement, the auditor should identify and assess the risks of material misstatement associated with related party relationships and transactions and determine whether any of those risks are significant risks. In making this determination, the auditor should treat identified significant related party transactions that are also significant unusual transactions outside the entity’s normal course of business as giving rise to significant risks.

[Paragraph .20 is renumbered as paragraph .21. The content is unchanged.]

.2122 As part of the requirement in section 330 that the auditor respond to assessed risks, the auditor should design and perform further audit procedures to obtain sufficient appropriate audit evidence about the assessed risks of material misstatement associated with related party relationships and transactions. The auditor should evaluate whether the entity has properly identified its related party relationships and transactions. Evaluating whether an entity has properly identified its related party relationships and transactions involves more than assessing the process used by the entity. The evaluation should include procedures to test the accuracy and completeness of the related party relationships and transactions identified by the entity, taking into account the information gathered during the audit.14 (Ref: par. .A34–.A37 .A35–.A38)

14 [Footnote omitted for purposes of this section.]
The auditor should perform procedures on balances with affiliated entities as of concurrent dates, even if fiscal years of the respective entities differ. The procedures performed should address the risks of material misstatement associated with the entity's accounts with affiliates.

Identified Significant Related Party Transactions That Are Required to Be Disclosed or Determined to be a Significant Risk Outside the Entity's Normal Course of Business

[Paragraphs .22–.23 are renumbered as paragraphs .24–.25. The content is unchanged.]

.24 Only for identified related party transactions that are required to be disclosed in the financial statements or determined to be a significant risk outside the entity's normal course of business, the auditor should:

a. inspect the underlying contracts or agreements, if any, and evaluate whether
   i. the business rationale of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets. (Ref: par. .A41–.A42, .A42–.A43)
   ii. the terms of the transactions are consistent with management's explanations.
   iii. the transactions have been appropriately accounted for and disclosed.

b. obtain audit evidence that the transactions have been appropriately authorized and approved. (Ref: par. .A43–.A44, .A45–.A46)

See paragraph .20, which requires the auditor to treat identified related party transactions that are also significant unusual transactions as giving rise to significant risks.

[Subsequent footnotes are renumbered.]

.25 Unless all of those charged with governance are involved in managing the entity, the auditor should communicate with those charged with governance significant findings and issues arising during the audit in connection with the entity's related parties. (Ref: par. .A52, .A53)

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

[Paragraph .28 is renumbered as paragraph .30. The content is unchanged. No amendment to paragraphs .A1–.A2.]

Related party relationships and transactions may cause the financial statements to fail to achieve fair presentation if, for example, the economic reality of such relationships and transactions is not appropriately reflected in the financial statements. For instance, fair presentation may not be achieved if the sale of a property by the entity to a controlling shareholder at a price above or below fair market value has been accounted for as a transaction involving a profit or loss for the entity when it may constitute a contribution or return of capital or the payment of a dividend.

[No amendment to paragraphs .A4–.A10.]
.A11 In the context of a group audit, section 600, Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors), requires the group engagement team to provide each component auditor with a list of information about related parties prepared by group management and any other related parties of which the group engagement team is aware, including the nature of the entity’s relationships and transactions with those related parties.\textsuperscript{22} When the entity is a component within a group, this information provides a useful basis for the auditor’s inquiries of management regarding the identity of the entity’s related parties.

\textsuperscript{22} [Footnote omitted for purposes of this section.]

[No amendment to paragraphs .A12–.A13.]

.A14 The inquiry about the identity of the entity’s related parties may include background information concerning the related parties, for example, physical location, industry, size, and extent of operations.

[Extant paragraph .A14 is renumbered as paragraph .A15. The content is unchanged.]

.A15\textsuperscript{16} Others within the entity are those considered likely to have knowledge of the entity’s related party relationships and transactions and the entity’s controls over such relationships and transactions, as well as the existence of related parties or relationships or transactions with related parties previously undisclosed to the auditor, and whether such relationships or transactions were with known or previously unknown related parties. These may include, to the extent that they do not form part of management, the following:

- Those charged with governance
- Personnel in a position to initiate, authorize, process, or record significant unusual transactions that are both significant and outside the entity’s normal course of business and those who supervise or monitor such personnel
- The internal audit function
- In-house legal counsel
- The chief ethics officer or equivalent person
- Chief compliance officer
- The human resources director or equivalent person

.A16\textsuperscript{17} The audit is conducted on the premise that management and, when appropriate, those charged with governance, have acknowledged and understand that they have responsibility for 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.\textsuperscript{24} Accordingly, the preparation of the financial statements requires management, with oversight from those charged with governance, to design, implement, and maintain adequate controls over related party relationships and transactions so that these are identified and appropriately accounted for and disclosed. In their oversight role, those charged with governance monitor how management is discharging its responsibility for such controls. Those charged with governance may, in their oversight role, obtain information from management to enable them to understand the nature and business rationale/purpose of the entity's related party relationships and transactions.

\textsuperscript{24} [Footnote omitted for purposes of this section.]
In meeting the requirement of section 315 to obtain an understanding of internal control, the auditor may consider features or elements relevant to mitigating the risks of material misstatement associated with related party relationships and transactions, such as the following:

- Internal ethical codes, appropriately communicated to the entity's personnel and enforced, governing the circumstances in which the entity may enter into specific types of related party transactions
- Policies and procedures for open and timely disclosure of the interests that management and those charged with governance have in related party transactions
- The assignment of responsibilities within the entity for identifying, recording, summarizing, and disclosing related party transactions
- Timely disclosure and discussion between management and those charged with governance of significant related party transactions that are also significant unusual transactions outside the entity's normal course of business, including whether those charged with governance have appropriately challenged the business rationale of such transactions (for example, by seeking advice from external professional advisers)
- Clear guidelines for the approval of related party transactions involving actual or perceived conflicts of interest, such as approval by a subcommittee of those charged with governance comprising individuals independent of management
- Periodic reviews by the internal audit function, when applicable
- Proactive action taken by management to resolve related party disclosure issues, such as by seeking advice from the auditor or external legal counsel
- The existence of whistle-blowing policies and procedures, when applicable

[Footnote omitted for purposes of this section.]

[Paragraph .A18 is renumbered as .A19. The content is unchanged.]

Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. The risk of management override of controls is higher if management has relationships that involve control or significant influence with parties with which the entity does business because these relationships may present management with greater incentives and opportunities to perpetrate fraud. For example, management’s financial interests in certain related parties may provide incentives for management to override controls by (a) directing the entity, against its interests, to conclude transactions for the benefit of these parties, or (b) colluding with such parties or controlling their actions. Examples of possible fraud include the following:

- Creating fictitious terms of transactions with related parties designed to misrepresent the business rationale of these transactions
- Fraudulently organizing the transfer of assets from or to management or others at amounts significantly above or below market value
Engaging in complex transactions with related parties, such as entities formed to accomplish specific purposes, that are structured to misrepresent the financial position or financial performance of the entity.

26 [Footnote omitted for purposes of this section.]

[Paragraph A20 is renumbered as A21. The content is unchanged.]

A21 Authorization and approval of significant transactions and arrangements (Ref: par. 15b). Authorization involves the granting of permission by a party or parties with the appropriate authority (whether management, those charged with governance, or the entity's shareholders) for the entity to enter into specific transactions in accordance with predetermined criteria, whether or not judgmental. Approval involves those parties' acceptance of the transactions the entity has entered into as having satisfied the criteria on which authorization was granted. Examples of controls the entity may have established to authorize and approve significant transactions and arrangements with related parties or significant unusual transactions, and arrangements outside the normal course of business include the following:

- Monitoring controls to identify such transactions and arrangements for authorization and approval
- Approval of the terms and conditions of the transactions and arrangements by management, those charged with governance, or, when applicable, shareholders

Remaining Alert—Maintaining Alertness for Related Party Information When Reviewing Records or Documents

[Paragraphs A22–A24 are renumbered as A23–A25. The content is unchanged.]

Identification of Significant Unusual Transactions Outside the Normal Course of Business (Ref: par. 1718)

A25 Obtaining further information on significant unusual transactions outside the entity's normal course of business enables the auditor to evaluate whether fraud risk factors, if any, are present and to identify the risks of material misstatement due to fraud.

A26 Examples of transactions that may be significant unusual transactions outside the entity's normal course of business may include the following:

- Complex equity transactions, such as corporate restructurings or acquisitions
- Transactions with offshore entities in jurisdictions with less rigorous corporate governance structures, laws, or regulations
- The leasing of premises or the rendering of management services by the entity to another party if no consideration is exchanged
- Sales transactions with unusually large discounts or returns
- Transactions with circular arrangements (for example, sales with a commitment to repurchase)
- Transactions under contracts whose terms are changed before expiration

A27 Understanding the nature of significant unusual transactions outside the normal course of business (Ref: par. 1718a). Inquiring into the nature of the significant unusual transactions outside the entity's normal course of business involves obtaining an understanding of the business rationale purpose of the
transactions and the terms and conditions under which these have been entered into.\textsuperscript{27}

\textsuperscript{27} [Footnote omitted for purposes of this section.]

\textbf{A2829} Inquiring into whether related parties could be involved (Ref: par. 17b).

A related party could be involved in a significant unusual transaction outside the entity's normal course of business not only by directly influencing the transaction by being a party to the transaction but also by indirectly influencing it through an intermediary. Such influence may indicate the presence of a fraud risk factor.

[No amendment to paragraphs .A29–.A34, renumbered as .A30–.A35.]

\textbf{A3536} Examples of substantive audit procedures that the auditor may perform when the auditor has assessed a significant risk that management has not appropriately accounted for or disclosed specific related party transactions (whether due to fraud or error) include the following:

- Confirming the business purposes, specific terms, or amounts of the transactions with the related parties (this audit procedure may be less effective when the auditor judges that the entity is likely to influence the related parties in their responses to the auditor).
- Inspecting evidence in possession of the other party or parties to the transaction.
- Confirming or discussing significant information with intermediaries, such as banks, guarantors, agents, or attorneys, to obtain a better understanding of the transaction.
- Referring to financial publications, trade journals, credit agencies, and other information sources when there is reason to believe that unfamiliar customers, suppliers, or other business enterprises with which material amounts of business have been transacted may lack substance.
- With respect to material uncollected balances, guarantees, and other obligations, obtaining evaluating information about the financial capability of the other party or parties to the transaction. Such information may be obtained from audited financial statements, unaudited financial statements, income tax returns, and reports issued by regulatory agencies, taxing authorities, financial publications, or credit agencies.

[No changes to paragraphs .A36–.A40, renumbered as .A37–.A41.]

\textbf{Identified—Significant Related Party Transactions Required To Be Disclosed or Determined to be a Significant Risk—Outside the Entity’s Normal Course of Business}

\textbf{Evaluating the Business Rationale Purpose of Significant Related Party Transactions (Ref: par. 2426a(i))}

\textbf{A4142} In evaluating the business rationale purpose of a significant related party transaction that is required to be disclosed in the financial statements or determined to be a significant risk outside the entity's normal course of business, the auditor may consider the following:

- Whether the transaction
  - is overly complex (for example, it may involve multiple related parties within a consolidated group)
— has unusual terms of trade, such as unusual prices, interest rates, guarantees, and repayment terms
— lacks an apparent logical business reason for its occurrence
— involves previously unidentified related parties
— is processed in an unusual manner

• Whether management has discussed the nature of, and accounting for, such a transaction with those charged with governance
• Whether management is placing more emphasis on a particular accounting treatment rather than giving due regard to the underlying economics of the transaction

If management's explanations are materially inconsistent with the terms of the related party transaction, the auditor is required to consider the reliability of management's explanations and representations on other significant matters.  

31 Paragraph .10 of section 500, Audit Evidence.

A4243 The auditor also may seek to understand the business purpose of such a transaction from the related party's perspective because this may help the auditor to better understand the economic purpose of the transaction and why it was carried out. A business purpose from the related party's perspective that appears inconsistent with the nature of its business may represent a fraud risk factor.

A4344 Authorization and approval by management, those charged with governance, or, when applicable, the shareholders of significant related party transactions that are required to be disclosed in the financial statements or determined to be a significant risk outside the entity's normal course of business may provide audit evidence that these have been duly considered at the appropriate levels within the entity, and that their terms and conditions have been appropriately reflected in the financial statements. The existence of transactions of this nature that were not subject to such authorization and approval, in the absence of rational explanations based on discussion with management or those charged with governance, may indicate risks of material misstatement due to fraud or error. In these circumstances, the auditor may need to be alert for other transactions of a similar nature. Authorization and approval alone, however, may not be sufficient in concluding whether risks of material misstatement due to fraud are absent because authorization and approval may be ineffective if there has been collusion between the related parties or if the entity is subject to the dominant influence of a related party.

A4445 Considerations specific to smaller entities. A smaller entity may not have the same controls provided by different levels of authority and approval that may exist in a larger entity. Accordingly, when auditing a smaller entity, the auditor may rely to a lesser degree on authorization and approval for audit evidence regarding the validity of significant related party transactions that are required to be disclosed in the financial statements or determined to be a significant risk outside the entity's normal course of business. Instead, the auditor may consider performing other audit procedures, such as inspecting relevant documents, confirming specific aspects of the transactions with relevant parties, or observing the owner-manager's involvement with the transactions. The discussion of management domination in paragraph .A32 and the fraud considerations discussed in paragraph .A8 provide further relevant guidance.

[Paragraphs .A45–.A50 are renumbered as paragraphs .A46–.A51. The content is unchanged.]
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Communication With Those Charged With Governance (Ref: par. 2729)

Evaluating the related party disclosures means considering whether the facts and circumstances of the entity's related party relationships and transactions have been appropriately summarized and presented so that the disclosures are understandable. Disclosures of related party transactions may not be understandable if

a. the business rationale and the effects of the transactions on the financial statements are unclear or misstated.

b. key terms, conditions, or other important elements of the transactions necessary for understanding them are not appropriately disclosed.

Communicating significant findings and issues arising during the audit in connection with the entity's related parties helps the auditor establish a common understanding with those charged with governance of the nature and resolution of these matters. Examples of significant related party findings and issues include the following:

- Nondisclosure (whether or not intentional) by management to the auditor of related parties or significant related party transactions, which may alert those charged with governance to significant related party relationships and transactions of which they may not have been previously aware
- The identification of significant related party transactions that have not been appropriately authorized and approved which may give rise to suspected fraud
- The identification of significant related party transactions that appear to lack a business purpose
- Disagreement with management regarding the accounting for, and disclosure of, significant related party transactions
- The inclusion of a statement in the financial statements that a transaction with a related party was conducted on terms equivalent to those prevailing in an arm's-length transaction
- Noncompliance with applicable laws or regulations prohibiting or restricting specific types of related party transactions
- Difficulties in identifying the party that ultimately controls the entity.

[Footnote omitted for purposes of this section.]

4. This amendment is effective for audits of financial statements for periods ending on or after December 15, 2020.

SAS No. 122, Section 210, Terms of Engagement

Section 210 addresses the auditor's responsibilities in agreeing upon the terms of the audit engagement with management and, when appropriate, those charged with governance. The amendment to section 210 is intended to enhance guidance relating to obtaining information about related parties and significant unusual transactions from predecessor auditors.

[No amendment to paragraphs .01–.A31.]

The communication with the predecessor auditor may be either written or oral. Matters subject to the auditor's inquiry of the predecessor auditor may include the following:
• Information that might bear on the integrity of management
• Disagreements with management about accounting policies, auditing procedures, or other similarly significant matters
• Communications to those charged with governance regarding fraud and noncompliance with laws or regulations by the entity
• Communications to management and those charged with governance regarding significant deficiencies and material weaknesses in internal control
• The predecessor auditor's understanding about the reasons for the change of auditors
• The predecessor auditor's understanding of the nature of the entity's relationships and transactions with related parties and significant unusual transactions

[No further amendment to section 210.]

6. This amendment is effective for audits of financial statements for periods ending on or after December 15, 2020.

SAS No. 122, Section 240, Consideration of Fraud in a Financial Statement Audit

7. Section 240 addresses the auditor’s responsibilities relating to fraud in an audit of financial statements. This amendment introduces the term significant unusual transactions and define it as significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual due to their timing, size, or nature. This amendment includes requirements for basic procedures for obtaining information for evaluating significant unusual transactions, and guidance and conforming changes related to significant unusual transactions.

[No amendment to paragraphs .01–.10.]

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

**Fraud.** An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception that results in a misstatement in financial statements that are the subject of an audit.

**Fraud risk factors.** Events or conditions that indicate an incentive or pressure to perpetrate fraud, provide an opportunity to commit fraud, or indicate attitudes or rationalizations to justify a fraudulent action. (Ref: par. .A11, .A30, and .A56)

*Significant unusual transactions. Significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual due to their timing, size, or nature.*

[No amendment to paragraphs .12–.16.]

.17 The auditor should make inquiries of management regarding

a. management’s assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent, and frequency of such assessments; (Ref: par. .A14–.A15)

b. management’s process for identifying, responding to, and monitoring the risks of fraud in the entity, including any specific risks of fraud that management has identified or that have been
brought to its attention, or classes of transactions, account balances, or disclosures for which a risk of fraud is likely to exist; (Ref: par. .A16)

c. management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity; and

d. management's communication, if any, to employees regarding its views on business practices and ethical behavior; and

e. whether the entity has entered into any significant unusual transactions and, if so, the nature, terms, and business purpose (or the lack thereof) of those transactions and whether such transactions involved related parties.

[No amendment to paragraph .18.]

.19 For those entities that have an internal audit function, the auditor should make inquiries of appropriate individuals within the internal audit function to obtain their views about the risks of fraud; determine whether they have knowledge of any actual, suspected, or alleged fraud affecting the entity; whether they have performed any procedures to identify or detect fraud during the year; and whether management has satisfactorily responded to any findings resulting from these procedures; and whether they are aware that the entity has entered into any significant unusual transactions. These inquiries are made, in part, to corroborate the responses received from the inquiries of management.

[No amendment to paragraphs .20–.31.]

.21 Unless all of those charged with governance are involved in managing the entity, the auditor should make inquiries of those charged with governance (or the audit committee or, at least, its chair) to determine their views about the risks of fraud, and whether they have knowledge of any actual, suspected, or alleged fraud affecting the entity, and whether the entity has entered into any significant unusual transactions. These inquiries are made, in part, to corroborate the responses received from the inquiries of management.

[No amendment to paragraphs .22–.31.]

.32 Even if specific risks of material misstatement due to fraud are not identified by the auditor, a possibility exists that management override of controls could occur. Accordingly, the auditor should address the risk of management override of controls apart from any conclusions regarding the existence of more specifically identifiable risks by designing and performing audit procedures to accomplish the following:

a. test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements, including entries posted directly to financial statement drafts. In designing and performing audit procedures for such tests, the auditor should (Ref: par. .A47–.A50 and .A.A56)

   i. obtain an understanding of the entity's financial reporting process and controls over journal entries and other adjustments, and the suitability of design and implementation of such controls;

   ii. make inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments;

   iii. consider fraud risk indicators, the nature and complexity of accounts, and unusual entries processed outside the normal course of business;
iv. select journal entries and other adjustments made at the end of a reporting period; and

v. consider the need to test journal entries and other adjustments throughout the period.

[No changes to list item b.]

c. Evaluate, for significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual—given the auditor’s understanding of the entity and its environment and other information obtained during the audit, whether the business purpose (or the lack thereof) of significant unusual transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets. The procedures should include the following: (Ref: par. .A54–.A55)

i. Reading the underlying documentation and evaluating whether the terms and other information about the transaction are consistent with explanations from inquiries and other audit evidence about the business purpose (or the lack thereof) of the transaction

ii. Determining whether the transaction has been authorized and approved in accordance with the entity’s established policies and procedures

iii. Evaluating whether significant unusual transactions that the auditor has identified have been properly accounted for and disclosed in the financial statements

12 Paragraph .19 of section 315.

[No amendment to paragraphs .33–.A18.]

.A19 Examples of others within the entity to whom the auditor may direct inquiries about the existence or suspicion of fraud include the following:

- Operating personnel not directly involved in the financial reporting process
- Employees with different levels of authority
- Employees involved in initiating, processing, or recording complex or unusual transactions (for example, a sales transaction with multiple elements or a significant related party transaction) and those who supervise or monitor such employees
- In-house legal counsel
- Chief ethics officer or equivalent person
- The person or persons charged with dealing with allegations of fraud

[No amendment to paragraphs .A20–.A53.]

Business RationalePurpose for Significant Unusual Transactions (Ref: par. .32c)

.A54 Indicators that may suggest that significant unusual transactions that are outside the normal course of business for the entity, or that otherwise
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appear to be unusual, may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets include the following:

- The form of such transactions appears overly complex (for example, the transaction involves multiple entities within a consolidated group or multiple unrelated third parties).
- Management has not discussed the nature of and accounting for such transactions with those charged with governance of the entity, and inadequate documentation exists.
- Management is placing more emphasis on the need for a particular accounting treatment than on the underlying economic substance of the transaction.
- Transactions that involve nonconsolidated related parties, including special purpose entities, have not been properly reviewed or approved by those charged with governance of the entity.
- Transactions that involve previously unidentified related parties or relationships or transactions with related parties previously undisclosed to the auditor.
- Transactions involve other parties that do not have the substance or the financial strength to support the transaction without assistance from the entity under audit or any related party of the entity.
- Transactions lack commercial or economic substance or are part of a larger series of connected, linked, or otherwise interdependent arrangements that lack commercial or economic substance individually or in the aggregate (for example, a transaction is entered into shortly prior to period end and is unwound shortly after period end).
- Transactions occur with a party that falls outside the definition of a related party (as defined by the applicable financial reporting framework), with either party able to negotiate terms that may not be available for other, more clearly independent parties on an arm’s-length basis.
- Transactions exist to enable the entity to achieve certain financial targets.

.A55 Procedures for evaluating significant unusual transactions may include evaluating the financial capability of the other parties with respect to significant uncollected balances, loan commitments, supply arrangements, guarantees and other obligations, if any. Examples of information that might be relevant to the auditor’s evaluation of a related party’s financial capability include, among other things, the audited financial statements of the related party, reports issued by regulatory agencies, financial publications, and income tax returns of the related party, to the extent available.

[Paragraphs .A55–.A70 are renumbered as .A56–.A71. The content is unchanged.]

.A71 Other matters related to fraud to be discussed with those charged with governance of the entity may include, for example, the following:

- Concerns about the nature, extent, and frequency of management's assessments of the controls in place to prevent and detect fraud and of the risk that the financial statements may be misstated.
• A failure by management to appropriately address identified significant deficiencies or material weaknesses in internal control or to appropriately respond to an identified fraud
• The auditor's evaluation of the entity's control environment, including questions regarding the competence and integrity of management
• Actions by management that may be indicative of fraudulent financial reporting, such as management's selection and application of accounting policies that may be indicative of management's effort to manage earnings in order to deceive financial statement users by influencing their perceptions concerning the entity's performance and profitability
• Concerns about the adequacy and completeness of the authorization of significant unusual transactions that appear to be outside the normal course of business.

[Paragraphs .A72–.A74 are renumbered as .A73–.A75. The content is unchanged.]

Appendix A—Examples of Fraud Risk Factors (Ref: par. .11, .24, and .A30)

No amendment to prior sections of this appendix.

Opportunities

The nature of the industry or the entity's operations provides opportunities to engage in fraudulent financial reporting that can arise from the following:

• Significant related party transactions not in the ordinary course of business or with related entities not audited or audited by another firm
• Related party transactions that are also significant unusual transactions
• Significant transactions with related parties whose financial statements are not audited or are audited by another firm
• A strong financial presence or ability to dominate a certain industry sector that allows the entity to dictate terms or conditions to suppliers or customers that may result in inappropriate or non-arm's-length transactions
• Assets, liabilities, revenues, or expenses based on significant estimates that involve subjective judgments or uncertainties that are difficult to corroborate
• Significant, unusual, or highly complex transactions or significant unusual transactions, especially those close to period end that pose difficult "substance over form" questions
• Significant operations located or conducted across jurisdictional borders where differing business environments and regulations exist
• Use of business intermediaries for which there appears to be no clear business justification

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• Significant bank accounts or subsidiary or branch operations in tax-haven jurisdictions for which there appears to be no clear business justification

• **Contractual arrangements lacking a business purpose**

The monitoring of management is not effective as a result of the following:

• Domination of management by a single person or small group (in a nonowner-managed business) without compensating controls.

• Oversight by those charged with governance over the financial reporting process and internal control is not effective.

• **The exertion of dominant influence by or over a related party.**

[No further amendment to this appendix.]

8. This amendment is effective for audits of financial statements for periods ending on or after December 15, 2020.

SAS No. 122, Section 265, *Communicating Internal Control Deficiencies Identified in an Audit*

9. Section 265 addresses the auditor's responsibility to appropriately communicate to those charged with governance and management deficiencies in internal control that the auditor has identified in an audit of financial statements. A conforming amendment is made for the use of the term *significant unusual transactions.*

[No amendment to paragraphs .01–.A7.]

.A8 Risk factors affect whether there is a reasonable possibility that a deficiency, or a combination of deficiencies, in internal control will result in a misstatement of an account balance or disclosure. The factors include, but are not limited to, the following:

• The nature of the financial statement classes of transactions, account balances, disclosures, and assertions involved

• The cause and frequency of the exceptions detected as a result of the deficiency, or deficiencies, in internal control

• The susceptibility of the related asset or liability to loss or fraud

• The subjectivity, complexity, or extent of judgment required to determine the amount involved

• The interaction or relationship of the control(s) with other controls

• The interaction with other deficiencies in internal control

• The possible future consequences of the deficiency, or deficiencies, in internal control

• The importance of the controls, such as the following, to the financial reporting process:

  — General monitoring controls (such as oversight of management)

  — Controls over the prevention and detection of fraud

  — Controls over the selection and application of significant accounting policies

  — Controls over significant transactions with related parties
— Controls over significant unusual transactions outside the entity's normal course of business
— Controls over the period-end financial reporting process (such as controls over nonrecurring journal entries)

[No further amendment to section 265.]

10. This amendment is effective for audits of financial statements for periods ending on or after December 15, 2020.

SAS No. 122, Section 315, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement

11. Section 315 addresses the auditor’s responsibility to identify and assess the risks of material misstatement in the financial statements through understanding the entity and its environment, including the entity’s internal control. A conforming amendment is made for the use of the term significant unusual transactions.

[No amendment to paragraphs .01–.29.]

.29 In exercising professional judgment about which risks are significant risks, the auditor should consider the following at least

[No amendment to list items a–e.]

f. whether the risk involves significant unusual transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual. (Ref: par. .A139–.A143)

[No amendment to paragraphs .30–.A35.]

.A36 An understanding of the entity's selection and application of accounting policies may encompass such matters as

• the methods the entity uses to account for significant unusual transactions.

[No amendment to the remainder of paragraph .A35.]

[No amendment to paragraphs .A37–.A147.]

.A148 Significant risks often relate to significant nonroutine unusual transactions and matters that require significant judgment. Nonroutine transactions are transactions that are unusual, either due to size or nature, and that, therefore, occur infrequently. Matters that require significant judgment may include the development of accounting estimates for which a significant measurement uncertainty exists. Routine, noncomplex transactions that are subject to systematic processing are less likely to give rise to significant risks.

.A149 Risks of material misstatement may be greater for significant nonroutine unusual transactions arising from matters such as the following:

• Greater management intervention to specify the accounting treatment
• Greater manual intervention for data collection and processing
• Complex calculations or accounting principles
• The nature of nonroutine unusual transactions, which may make it difficult for the entity to implement effective controls over the risks
• Related party transactions

[No amendment to paragraphs .A150–.A152.]
Although risks relating to significant nonroutine unusual transactions or matters that require significant judgment are often less likely to be subject to routine controls, management may have other responses intended to deal with such risks. Accordingly, the auditor's understanding of whether the entity has designed and implemented controls for significant risks arising from nonroutine unusual transactions or matters that require significant judgment includes whether and how management responds to the risks. Such responses might include

- control activities, such as a review of assumptions by senior management or specialists.
- documented processes for estimations.
- approval by those charged with governance

[No further amendment to section 315.]

12. This amendment is effective for audits of financial statements for periods ending on or after December 15, 2020.

SAS No. 122, Section 330, Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained

13. Section 330 addresses the auditor's responsibility to design and implement responses to the risks of material misstatement identified and assessed by the auditor in accordance with section 315, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement, and to evaluate the audit evidence obtained in an audit of financial statements. A conforming amendment is made for the use of the term significant unusual transactions.

[No amendment to paragraphs .01–.A57. Paragraph .A58 is amended to include new text and is split into two paragraphs.]

.A58 Paragraph .22 requires the auditor to perform substantive procedures that are specifically responsive to risks the auditor has determined to be significant risks. Because significant unusual transactions can affect the risks of material misstatement due to error or fraud, substantive procedures that take into account the types of potential misstatements that could result from significant unusual transactions may be necessary, including procedures performed pursuant to paragraph .32 of section 240.

.A59 Audit evidence in the form of external confirmations received directly by the auditor from appropriate confirming parties may assist the auditor in obtaining audit evidence with the high level of reliability that the auditor requires to respond to significant risks of material misstatement, whether due to fraud or error. For example, if the auditor identifies that management is under pressure to meet earnings expectations, a risk may exist that management is inflating sales by improperly recognizing revenue related to sales agreements with terms that preclude revenue recognition or by invoicing sales before shipment. In these circumstances, the auditor may, for example, design external confirmation procedures not only to confirm outstanding amounts but also to confirm the details of the sales agreements, including date, any rights of return, and delivery terms. In addition, the auditor may find it effective to supplement such external confirmation procedures with inquiries of nonfinancial personnel in the entity regarding any changes in sales agreements and delivery terms.

[Paragraphs .A59–.A76 are renumbered as .A60–.A77. The content is unchanged.]

14. This amendment is effective for audits of financial statements for periods ending on or after December 15, 2020.
SAS No. 122, Section 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements*

15. Section 510 addresses the auditor’s responsibilities relating to opening balances in an initial audit engagement, including a reaudit engagement. The amendment is intended to enhance guidance relating to obtaining information about related parties and significant unusual transactions from predecessor auditors.

[No amendment to paragraphs .01–.A4.]

.A5 It is customary for the predecessor auditor to make himself or herself available to the auditor and to make available for review certain audit documentation. The predecessor auditor determines which audit documentation is to be made available for review and which may be copied. The predecessor auditor ordinarily permits the auditor to review audit documentation, including documentation of planning; risk assessment procedures; further audit procedures; audit results; and other matters of continuing accounting and auditing significance, such as the schedule of uncorrected misstatements, working paper analysis of balance sheet accounts, and those relating to contingencies, related parties, and significant unusual transactions.

[No further amendment to section 510.]

16. This amendment is effective for audits of financial statements for periods ending on or after December 15, 2020.

SAS No. 122, Section 560, *Subsequent Events and Subsequently Discovered Facts*

17. Section 560 addresses the auditor’s responsibilities relating to subsequent events and subsequently discovered facts in an audit of financial statements. The amendment is intended to enhance guidance relating to obtaining information about subsequent events.

[No amendment to paragraphs .01–.A5.]

.A6 In inquiring of management and, when appropriate, those charged with governance about whether any subsequent events have occurred that might affect the financial statements, the auditor may inquire about the current status of items that were accounted for on the basis of preliminary or inconclusive data and may make specific inquiries about the following matters:

- Whether new commitments, borrowings, or guarantees have been entered into
- Whether sales or acquisitions of assets have occurred or are planned
- Whether there have been increases in capital or issuance of debt instruments, such as the issue of new shares or debentures, or an agreement to merge or liquidate has been made or is planned
- Whether any assets have been appropriated by the government or destroyed (for example, by fire or flood)
- Whether there have been any developments regarding contingencies
- Whether any unusual accounting adjustments have been made or are contemplated
- Whether any events have occurred or are likely to occur that will bring into question the appropriateness of accounting policies used in the financial statements, as would be the case, for
example, if such events call into question the validity of the going concern assumption

- Whether any events have occurred that are relevant to the measurement of estimates or provisions made in the financial statements
- Whether any events have occurred that are relevant to the recoverability of assets
- **Whether there have been any changes in the entity’s related parties**
- **Whether there have been any significant new related party transactions**
- **Whether the entity has entered into any significant unusual transactions**

[No further amendment to section 560.]

18. This amendment is effective for audits of financial statements for periods ending on or after December 15, 2020.

SAS No. 122, Section 580, Written Representations

19. Section 580 addresses the auditor's responsibilities to obtain written representations from management and, when appropriate, those charged with governance in an audit of financial statements. This amendment is intended to enhance guidance relating to obtaining representations about related parties and related party transactions.

[No amendment to paragraphs .01–.16.]

.17 The auditor should request management to provide written representations that (Ref: par. .A15–.A16)

a. it has disclosed to the auditor the identity of all the entity's related parties and all the related party relationships and transactions of which it is aware and

b. it has appropriately accounted for and disclosed such relationships and transactions.

[No amendment to paragraphs .18–.A14.]

.A15 Circumstances in which it may be appropriate to obtain written representations about related parties from those charged with governance in addition to management include the following:

- When they have approved specific related party transactions that (a) materially affect the financial statements or (b) involve management
- When they have made specific oral representations to the auditor on details of certain related party transactions
- When they have financial or other interests in the related parties or the related party transactions

.A16 The auditor also may decide to obtain written representations regarding specific assertions that management may have made, such as a representation that specific related party transactions do not involve undisclosed side agreements, or that a transaction with a related party was conducted on terms equivalent to those prevailing in an arm's-length transaction.

[No amendment to paragraphs .A16–.A17.]
In addition to the written representations required by paragraphs .10–.18, the auditor may consider it necessary to request other written representations about the financial statements. Such written representations may supplement, but do not form part of, the written representations required by paragraphs .10–.18. They may include representations about the following:

- Whether the selection and application of accounting policies are appropriate
- Whether matters such as the following, when relevant under the applicable financial reporting framework, have been recognized, measured, presented, or disclosed in accordance with that framework:
  - Plans or intentions that may affect the carrying value or classification of assets and liabilities
  - Liabilities, both actual and contingent
  - Title to, or control over, assets and the liens or encumbrances on assets and assets pledged as collateral
- Aspects of laws, regulations, and contractual agreements that may affect the financial statements, including noncompliance
- **Whether any side agreements or other arrangements (either written or oral) exist that have not been disclosed to the auditor**

[No further amendment to section 580.]

20. This amendment is effective for audits of financial statements for periods ending on or after December 15, 2020.

SAS No. 122, Section 600, Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)

21. Section 600 addresses special considerations that apply to group audits, in particular those that involve component auditors. The amendment is intended to enhance requirements relating to obtaining information about related parties.

[No amendment to paragraphs .01–.40.]

.41 The group engagement team should communicate its requirements to a component auditor on a timely basis. This communication should include the following:

[No amendment to list items a–b.]

c. A list of related parties prepared by group management and any other related parties of which the group engagement team is aware, **including the nature of the entity's relationships and transactions with those related parties.** The group engagement team should request the component auditor to communicate on a timely basis related parties not previously identified by group management or the group engagement team. The group engagement team should identify such additional related parties to other component auditors.

[No amendment to paragraphs .42–.A93.]

.A94 The examples provided cover a broad range of matters; however, not all matters are relevant to every group audit engagement, and the list of examples is not necessarily complete.
...Consolidation Process

The group engagement team’s understanding of the consolidation process may include matters such as the following:

- Matters relating to consolidation adjustments, such as the following:
  - The process for recording consolidation adjustments, including the preparation, authorization, and processing of related journal entries and the experience of personnel responsible for the consolidation
  - The consolidation adjustments required by the applicable financial reporting framework
  - Business rationale for the events and transactions that gave rise to the consolidation adjustments

[No further amendment to section 600.]

22. This amendment is effective for audits of group financial statements for periods ending on or after December 15, 2020.

SAS No. 122, Section 930, Interim Financial Information

23. Section 930 addresses the auditor’s responsibilities when engaged to review interim financial information under specified conditions. This amendment is intended to enhance guidance relating to obtaining information about related parties and significant unusual transactions.

[No amendment to paragraphs .01–.20.]

.21 For all interim financial information presented and for all periods covered by the review, the auditor should request management to provide written representations, as of the date of the auditor’s review report (Ref: par. .A29–.A30)

[No amendment to list items a–l.]

m. that management has disclosed to the auditor the identity of all the entity’s related parties and all the related party relationships and transactions of which it is aware, and it has appropriately accounted for and disclosed such relationships and transactions.

[No amendment to list item n.]

[No amendment to paragraphs .21–.A29.]

.A30 The auditor may request additional representations, including representations regarding the following:

- Matters specific to the entity’s business or industry
- Support for any assertion that a transaction with a related party was conducted on terms equivalent to those prevailing in an arm’s-length transaction
- Whether any side agreements or other arrangements (either written or oral) exist that have not been disclosed to the auditor

[No amendment to paragraphs .A31–.A54.]
Appendix B — Unusual or Complex Situations to Be Considered by the Auditor When Conducting a Review of Interim Financial Information (Ref: par. .A18)

The following are examples of situations about which the auditor may inquire of management:

- Business combinations
- New or complex revenue recognition methods
- Impairment of assets
- Disposal of a segment of a business
- Use of derivative instruments and hedging activities
- Sales and transfers that may call into question the classification of investments in securities, including management's intent and ability with respect to the remaining securities classified as held to maturity
- Adoption of new stock compensation plans or changes to existing plans
- Restructuring charges taken in the current and prior quarters
- Significant, unusual, or infrequently occurring transactions
- Infrequent transactions
- Significant unusual transactions
- Changes in litigation or contingencies
- Changes in major contracts with customers or suppliers
- Application of new accounting principles
- Changes in accounting principles or the methods of applying them
- Trends and developments affecting accounting estimates, such as allowances for bad debts and excess or obsolete inventories, provisions for warranties and employee benefits, and realization of unearned income and deferred charges
- Compliance with debt covenants
- Changes in related parties or significant new related party transactions
- Material off-balance-sheet transactions, special purpose entities, and other equity investments
- Unique terms for debt or capital stock that could affect classification

[No further amendment to section 930.]

24. This amendment is effective for reviews of interim financial information for interim periods of fiscal years ending on or after December 15, 2020.

SAS No. 130, Section 940, An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements

25. Section 940 establishes requirements and provides guidance that applies only when an auditor is engaged to perform an audit of internal control over financial reporting that is integrated with an audit of financial statements. The amendment is a conforming amendment for the use of the term significant unusual transactions.

[No amendment to paragraphs .01–.A24.]
Section 240 addresses the auditor's identification and assessment of the risks of material misstatement due to fraud. Controls that might address these risks include

- controls over significant, unusual transactions, particularly those that result in late or unusual journal entries
- controls over journal entries and adjustments made in the period-end financial reporting process
- controls over related party transactions
- controls related to significant management estimates
- controls that mitigate incentives for, and pressures on, management to falsify or inappropriately manage financial results

13 [Footnote omitted for purposes of this section.]

[No amendment to paragraphs .A26–.A90.]

Risk factors affect whether there is a reasonable possibility that a deficiency, or a combination of deficiencies, in ICFR will result in a misstatement of an account balance or a disclosure. The factors include the following:

- The nature of the financial statement, classes of transactions, account balances, disclosures, and assertions involved
- The cause and frequency of the exceptions detected as a result of the deficiency, or deficiencies, in ICFR
- The susceptibility of the related asset or liability to loss or fraud
- The subjectivity, complexity, or extent of judgment required to determine the amount involved
- The interaction or relationship of the control(s) with other controls
- The interaction with other deficiencies in ICFR
- The possible future consequences of the deficiency, or deficiencies, in ICFR
- The importance of controls, such as the following, to the financial reporting process:
  - General monitoring controls (such as oversight of management)
  - Controls over the prevention and detection of fraud
  - Controls over the selection and application of significant accounting policies
  - Controls over significant transactions with related parties
  - Controls over significant unusual transactions outside the entity's normal course of business
  - Controls over the period-end financial reporting process (such as controls over nonrecurring journal entries)

[No further amendment to section 940.]

This amendment is effective for integrated audits for periods ending on or after December 15, 2020.