

## AU-C Section 9700

### *Forming an Opinion and Reporting on Financial Statements: Auditing Interpretations of AU-C Section 700*

#### Introduction

On June 1, 2017, the PCAOB adopted Auditing Standard (AS) 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*.<sup>14</sup> The SEC approved AS 3101 and related amendments on October 23, 2017. AS 3101 retains the pass or fail opinion of the existing PCAOB auditor's report but makes significant changes to the existing PCAOB auditor's report, including the following:

- Requiring communication of critical audit matters (CAMs). Any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that
  - relates to accounts or disclosures that are material to the financial statements and
  - involved especially challenging, subjective, or complex auditor judgment;
- Requiring disclosure of auditor tenure. The year in which the auditor began serving consecutively as the company's auditor
- Other improvements to the auditor's report. Clarification of the auditor's role and responsibilities, such as a statement regarding the requirement for the auditor to be independent with respect to the company, and making the auditor's report easier to read

Among the other revisions, AS 3101 specifies the form of the report, including requirements related to the order of presentation and section titles. All the changes, except those relating to CAMs, are effective for audits of fiscal years ending on or after December 15, 2017.<sup>15</sup>

*continued*

<sup>14</sup> All PCAOB auditing standards can be found in AICPA *PCAOB Standards and Related Rules*.

<sup>15</sup> PCAOB Release No. 2017-001, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards*, was issued June 1, 2017, and was approved by the SEC on October 23, 2017. *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) (updated as of December 28, 2017), was prepared by PCAOB staff to help firms when implementing changes to the auditor's report effective for audits of fiscal years ending on or after December 15, 2017.



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As noted in PCAOB Release No. 2017-001, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards*,

There are situations in which an auditor may be required by law or regulation, or voluntarily agrees, to perform an audit engagement in accordance with PCAOB standards for a company whose audit is not subject to PCAOB oversight.<sup>112</sup> For example, SEC rules permit audits under PCAOB standards in connection with offerings under Regulation A and Regulation Crowdfunding. In these situations, certain elements of the auditor's report required under the final standard, such as the use of "registered public accounting firm" in the title or the statement regarding independence requirements, may not apply.

<sup>112</sup> Under the Sarbanes-Oxley Act, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, the PCAOB oversees the audits of "issuers" and brokers and dealers reporting under Exchange Act Rule 17a-5. See Sarbanes-Oxley Act Section 101. An "issuer" under the Sarbanes-Oxley Act is an entity whose securities are registered under Section 12 of the Exchange Act, or that is required to file reports under Section 15(d) of the Exchange Act, or that files or has filed a Securities Act registration statement that has not yet become effective and that it has not withdrawn. See Sarbanes-Oxley Section 2(a).

Generally accepted auditing standards (GAAS) currently address the appropriate form of report when an auditor issues a report referencing both GAAS and the standards of the PCAOB. AU-C section 700, *Forming an Opinion and Reporting on Financial Statements*,<sup>16, 17</sup> states

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 as defined by the Sarbanes-Oxley Act of 2002 (the Act), as amended, the auditor is required to also conduct the audit in accordance with GAAS. In such circumstances, when the auditor refers to the standards of the PCAOB in addition to GAAS in the auditor's report, the auditor should use the form of report required by the standards of the PCAOB, amended to state that the audit was also conducted in accordance with GAAS.

Auditing Interpretation No. 4, "Reporting on Audits Conducted in Accordance With Auditing Standards Generally Accepted in the United States of America and the Standards of the PCAOB" (paragraphs .14-.21), provides guidance on how an auditor complies with AU-C section 700<sup>18</sup> in the context of the revised reporting standards adopted by the PCAOB and approved by the SEC. Because of the phased approach of the effective dates of AS 3101, Auditing Interpretation No. 4 does not address the changes relating to CAMs. The AICPA Auditing Standards Board will continue to assess whether it will be necessary to develop additional auditing interpretations.

<sup>16</sup> All AU-C sections can be found in AICPA *Professional Standards*.

<sup>17</sup> Paragraph .44 of AU-C section 700, *Forming an Opinion and Reporting on Financial Statements*.

<sup>18</sup> See footnote 17.

Although Auditing Interpretation No. 4 has been determined to be consistent with GAAS, the interpretation should not be construed to be an interpretation of PCAOB standards. Moreover, Auditing Interpretation No. 4 has not been approved or acted upon by the PCAOB.

#### **4. Reporting on Audits Conducted in Accordance With Auditing Standards Generally Accepted in the United States of America and the Standards of the PCAOB**

**.14 Question**—AU-C section 700<sup>19</sup> states, in part, that the auditor should use the form of report required by the standards of the PCAOB. Are there any elements of the auditor’s report required by the standards of the PCAOB whose presentation may need to be revised in order to comply with the PCAOB reporting requirements?

**.15 Interpretation**—Yes. To appropriately apply the requirement in AU-C section 700<sup>20</sup> to follow the PCAOB form of the report, the auditor will need to evaluate the circumstances of the engagement and also may need to modify the report as described in the following paragraphs to avoid making an untrue statement.

**.16 Question**—Paragraph .06 of AS 3101 states that the auditor “must include the title, ‘Report of Independent Registered Public Accounting Firm’” and the related description in the “Basis for Opinion” section of the report required by paragraph .09g of AS 3101. Is it appropriate for an auditor to revise the report by removing the references to “registered” if the firm is not registered with the PCAOB?

**.17 Interpretation**—Yes, removing the reference to “registered” from the title and from the “Basis for Opinion” section of the report is appropriate if the firm is not registered with the PCAOB. As noted in *Staff Questions and Answers—Audits of Financial Statements of Non-Issuers Performed Pursuant to the Standards of the Public Company Accounting Oversight Board*,<sup>21</sup> dated June 30, 2004, a public accounting firm does not need to be registered with the PCAOB to perform an audit of a nonissuer in accordance with PCAOB standards.

**.18 Question**—How should the auditor address the requirement in paragraph .09g of AS 3101 that notes that the auditor “is 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 SEC and the PCAOB”?

**.19 Interpretation**—Generally, GAAS do not require the auditor to be independent under SEC and PCAOB standards unless required by law or regulation. Therefore, it would be appropriate in those circumstances for the auditor to revise the statement in the report regarding independence to reflect the circumstances of the engagement. For example, if the auditor is not required to be independent under U.S. federal securities laws and the applicable rules and regulations of the SEC and the PCAOB, this statement may be amended to read, “We are required to be independent with respect to the Company in accordance with the relevant ethical

<sup>19</sup> See footnote 17.

<sup>20</sup> See footnote 17.

<sup>21</sup> AICPA, *PCAOB Standards and Related Rules*, PCAOB Staff Guidance, sec. 100.01.

requirements relating to our audit” (see example 6). AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, explains that relevant ethical requirements consist of the AICPA Code of Professional Conduct together with rules of state boards of accountancy and applicable regulatory agencies that are more restrictive.<sup>22</sup> Relevant ethical requirements may exist in several different sources, such as ethical codes and additional rules and requirements within law and regulation. Depending on the circumstances, for example, when independence and ethical requirements are contained in a limited number of sources, the auditor may choose to name the relevant sources (such as the AICPA Code of Professional Conduct) or rule or applicable regulation or may refer to a term that appropriately describes those sources.

.20 In addition, the auditor may need to revise the reference to “the standards” of the PCAOB as described in AU-C section 700.<sup>23</sup> As noted in AU-C section 700,<sup>24</sup> 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)” is limited to compliance with 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.

.21 The following are two examples of auditor’s reports on comparative financial statements when the audits are conducted in accordance with both GAAS and either the standards of the PCAOB or the auditing standards of the PCAOB.

### Example 5

#### **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.

<sup>22</sup> Paragraph .A15 of AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

<sup>23</sup> Paragraph .A45 of AU-C section 700.

<sup>24</sup> See footnote 10.

- The firm is registered with the PCAOB and for purposes of this engagement is required by regulation to be in compliance with the independence standards and other professional practice standards of the PCAOB and SEC.
- Management is not required to report on the entity’s internal control over financial reporting.
- The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America.

### **Report of Independent Registered Public Accounting Firm**

[*To the Shareholders and the Board of Directors of X Company*<sup>25</sup>]

#### **Opinion on the Financial Statements**

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

#### **Basis for Opinion**

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

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<sup>25</sup> See paragraph .07 of PCAOB AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion. Staff Guidance—Changes to the Auditor's Report Effective for Audits of Fiscal Years Ending on or After December 15, 2017*, 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.

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.<sup>26</sup>

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

The critical audit matters communicated below are matters arising from the current period audit of the financial statements that were communicated or required to be communicated to the audit committee<sup>27</sup> and that: (1) relate to accounts or disclosures that are material to

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<sup>26</sup> As described in paragraphs .59–.60 of AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*, this section should be revised in situations in which management is required to report on the effectiveness of internal control over financial reporting but such report is not required to be audited, and the auditor has not been engaged to perform an audit of management’s assessment of the effectiveness of internal control over financial reporting. The following paragraphs should replace the second paragraph in the “Basis for Opinion” section in those circumstances. A similar paragraph may voluntarily be included in the auditor’s report in situations in which management is not required to report on internal control over financial reporting and neither is the auditor.

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

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

<sup>27</sup> AS 1301, *Communications with Audit Committees*, defines “audit committee” as

A committee (or equivalent body) established by and among the board of directors of a company for the purpose of overseeing the accounting and financial reporting processes of the company and audits of the

the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

*[Include critical audit matters]*

*[Signature]*

We have served as the Company's auditor since [year].<sup>28</sup>

*[City and State or Country]*

*[Date]*

## Example 6

### **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**

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.

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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.

<sup>28</sup> As discussed in *Staff Guidance—Changes to the Auditor's Report Effective for Audits of Fiscal Years Ending on or After December 15, 2017*, AS 3101 does not specify a required location within the auditor's report for the statement on auditor tenure. The sample auditor's report includes the statement on auditor tenure at the end of the report; however, auditors have discretion to present auditor tenure in the part of the auditor's report they consider appropriate.

- The firm is not registered with the PCAOB and for purposes of this engagement is not required to be in compliance with the independence standards and other professional practice standards of the PCAOB and SEC.
- Management is not required to report on the entity’s internal control over financial reporting.
- The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America.

### **Report of Independent Public Accounting Firm**

[*To the Shareholders and the Board of Directors of X Company*<sup>29</sup>]

#### **Opinion on the Financial Statements**

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

#### **Basis for Opinion**

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

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

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<sup>29</sup> See paragraph .07 of PCAOB AS 3101. *Staff Guidance—Changes to the Auditor’s Report Effective for Audits of Fiscal Years Ending on or After December 15, 2017*, 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.

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.<sup>30</sup>

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

The critical audit matters communicated below are matters arising from the current period audit of the financial statements that were communicated or required to be communicated to the audit committee<sup>31</sup> and that: (1) relate to accounts or disclosures that are material to

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<sup>30</sup> As described in paragraphs .59–.60 of AS 3105, 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. Accordingly, we express no such opinion.

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

<sup>31</sup> AS 1301, 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.

the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

*[Include critical audit matters]*

*[Signature]*

We have served as the Company's auditor since [year].<sup>32</sup>

*[City and State or Country]*

*[Date]*

[Issue Date: March 2018.]

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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.

<sup>32</sup> As discussed in *Staff Guidance—Changes To The Auditor's Report Effective For Audits of Fiscal Years Ending On or After December 15, 2017*, AS 3101 does not specify a required location within the auditor's report for the statement on auditor tenure. The example auditor's report includes the statement on auditor tenure at the end of the report; however, auditors have discretion to present auditor tenure in the part of the auditor's report they consider appropriate.