



## Agenda Item 1H (706)

### Proposed SAS, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*

ISA 706 (Revised)	Extant AU-C 706	Proposed SAS
	<b>Exhibit A—Illustrations of Auditor's Reports With Emphasis-of-Matter or Other-Matter Paragraphs</b>	
	Illustration 1 — An Auditor's Report With an Emphasis-of-Matter Paragraph Because There Is Uncertainty Relating to a Pending Unusually Important Litigation Matter	Illustration 1 — An Auditor's Report With an Emphasis-of-Matter Paragraph Because There Is Uncertainty Relating to a Pending Unusually Important Litigation Matter
Exhibit D - Illustration of an Auditor's Report that Includes a Key Audit Matters Section, an Emphasis of Matter Paragraph, and an Other Matter Paragraph		Illustration 2 – Illustration of an Auditor's Report that Includes a Key Audit Matters Section, an Emphasis of Matter Paragraph, and an Other Matter Paragraph
	Illustration 2 — An Auditor's Report With an Other-Matter Paragraph That May Be Appropriate When an Auditor Issues an Updated Report on the Financial Statements of a Prior Period That Contains an Opinion	Illustration 3 — An Auditor's Report With an Other-Matter Paragraph That May Be Appropriate When an Auditor Issues an Updated Report on the Financial Statements of a Prior Period That Contains an Opinion

Illustrative Reports (706) – Proposed SAS EOM & OM  
ASB Meeting, July 17-20, 2017

<b>ISA 706 (Revised)</b>	<b>Extant AU-C 706</b>	<b>Proposed SAS</b>
	Different From the Opinion Previously Expressed	Different From the Opinion Previously Expressed
Exhibit E - Illustration of an Auditor's Report Containing a Qualified Opinion Due to a Departure from the Applicable Financial Reporting Framework and that Includes an Emphasis of Matter Paragraph	Illustration 3 — An Auditor's Report With a Qualified Opinion Due to a Material Misstatement of the Financial Statements and an Emphasis-of-Matter Paragraph Because There Is Uncertainty Relating to a Pending Unusually Important Litigation Matter	Illustration 4 — An Auditor's Report With a Qualified Opinion Due to a Material Misstatement of the Financial Statements and an Emphasis-of-Matter Paragraph Because There Is Uncertainty Relating to a Pending Unusually Important Litigation Matter

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**EXHIBIT A — ILLUSTRATIONS OF AUDITOR’S REPORTS WITH EMPHASIS-OF-MATTER OR OTHER-MATTER PARAGRAPHS**

Illustration 1 — An Auditor’s Report With an Emphasis-of-Matter Paragraph Because There Is Uncertainty Relating to a Pending Unusually Important Litigation Matter

Illustration 2 – Illustration of an Auditor’s Report that Includes a Key Audit Matters Section, an Emphasis of Matter Paragraph, and an Other Matter Paragraph

Illustration ~~23~~ — An Auditor’s Report With an Other-Matter Paragraph That May Be Appropriate When an Auditor Issues an Updated Report on the Financial Statements of a Prior Period That Contains an Opinion Different From the Opinion Previously Expressed

Illustration ~~43~~ — An Auditor’s Report With a Qualified Opinion Due to a Material Misstatement of the Financial Statements and an Emphasis-of-Matter Paragraph Because There Is Uncertainty Relating to a Pending Unusually Important Litigation Matter

Note: In the following illustrations, the **Opinion** section has been positioned first in accordance with proposed SAS, Forming an Opinion and Reporting on Financial Statements, and the **Basis for Opinion** section is positioned immediately after the **Opinion** section. Also, the first sentence of the second paragraph and last sentence that was included in the extant auditor’s responsibilities section is now subsumed as part of the new **Basis for Opinion** section.

Illustration 1 — An Auditor’s Report With an Emphasis-of-Matter Paragraph Because There Is Uncertainty Relating to a Pending Unusually Important Litigation Matter

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (single year). [The audit is not a group audit.](#)
- The financial statements are prepared [by management of the company](#) in accordance with accounting principles generally accepted in the United States of America.
- The terms of the audit engagement reflect the description of management’s responsibility for the financial statements in AU-C section 210.
- The auditor has concluded an unmodified (i.e., “clean”) opinion is appropriate based on the audit evidence obtained.
- There is uncertainty relating to a pending unusually important litigation matter.
- The auditor’s report includes an emphasis-of-matter paragraph.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time in accordance with AU-C section 570.
- The auditor has obtained all of the other information prior to the date of the auditor’s report and has not identified a material misstatement of the other information.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- The auditor is not communicating key audit matters in the auditor’s report.

**Independent Auditor's Report**

[Appropriate Addressee]

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

***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.

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

**Basis for Opinion**

We conducted our audit 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 independent of ABC Company in accordance with ethical requirements that are relevant to our audit of the financial statements, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence that 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 is a defendant in a lawsuit [*briefly describe the nature of the litigation consistent with the Company's description in the note to the financial statements*]. Our opinion is not modified with respect to this matter.

**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 proposed SAS, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports – see Illustration 1 in appendix of proposed SAS, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports.]

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

**Responsibilities of Management and Those Charged With Governance's Responsibility for the Financial Statements**

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

In preparing the financial statements, management is responsible for assessing ABC Company's ability to continue as a going concern in accordance with accounting principles generally accepted in the United States of America, and using 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 responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.~~

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. 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 taken on the basis of these financial statements.

As part of an audit in accordance with GAAS, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess 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, 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.

- Obtain an understanding of ~~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 ABC Company's entity's internal control.<sup>2</sup> Accordingly, ~~we express~~ no such opinion is expressed.
- Evaluate ~~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.
- Conclude on ABC Company's ability to continue as a going concern and conclude on the appropriateness of management's use of the going concern basis of accounting.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies and material weaknesses in internal control that we identified during our audit.

~~We believe that the audit evidence that 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 is a defendant in a lawsuit [briefly describe the nature of the litigation consistent with the Company's description in the note to the financial statements]. Our opinion is not modified with respect to this matter.~~

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

~~[The f~~Form and content of this section of the auditor's report would~~#] vary depending on the nature of the auditor's other reporting responsibilities.]~~

~~[~~Auditor's s~~Signature of the auditor's firm]~~

~~[~~Auditor's city and state]

~~[~~Date of the auditor's report]

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<sup>2</sup> In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances." In addition, the next sentence, "Accordingly, we express no such opinion." would not be included.

Illustration 2 — An Auditor’s Report that Includes a Key Audit Matters Section, an Emphasis-of-Matter Paragraph, and an Other-Matter Paragraph.

Circumstances include the following:

- Audit of a complete set of general purpose financial statements. The audit is not a group audit.
- The financial statements are prepared by management of the company in accordance with accounting principles generally accepted in the United States of America.
- The terms of the audit engagement reflect the description of management’s responsibility for the financial statements in AU-C section 210.
- The auditor has concluded an unmodified (i.e., “clean”) opinion is appropriate based on the audit evidence obtained.
- Between the date of the financial statements and the date of the auditor’s report, there was a fire in the entity’s production facilities, which was disclosed by the entity as a subsequent event. In the auditor’s judgment, the matter is of such importance that it is fundamental to users’ understanding of the financial statements. The matter did not require significant auditor attention in the audit of the financial statements in the current period.
- The prior period financial statements were audited by a predecessor auditor
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time in accordance with AU-C section 570.
- The auditor has obtained all of the other information prior to the date of the auditor’s report and has not identified a material misstatement of the other information.
- Key audit matters have been communicated in accordance with proposed SAS, *Communicating Key Audit Matters in the Independent Auditor’s Report*.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.

## Independent Auditor’s Report

[Appropriate Addressee]

### Report on the Audit of the Financial Statements<sup>3</sup>

#### Opinion

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

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

#### Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 in accordance with ethical requirements that are relevant to our audit of the financial statements and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

#### Emphasis of Matter<sup>4</sup>

As discussed in Note X to the financial statements, which describes the effects of a fire in the Company’s production facilities. Our opinion is not modified with respect to this matter.

#### Key Audit Matters

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

<sup>3</sup> The sub-title “Report on the Audit of the Financial Statements” is unnecessary in circumstances when the second sub-title “Report on Other Legal and Regulatory Requirements” is not applicable.

<sup>4</sup> ——As noted in paragraph A16, an ~~Emphasis-of-matter~~ paragraph may be presented either directly before or after the Key Audit Matters section based on the auditor’s judgment as to the relative significance of the information included in the ~~emphasis-of-matter~~ paragraph.

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

### Other Matter

The financial statements of ABC Company for the year ended December 31, 20X0, were audited by another auditor, who expressed an unmodified opinion on those statements on March 31, 20X1.

### 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 proposed SAS, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports – see Illustration 1 in appendix of proposed SAS, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports.]

### Responsibilities of Management and Those Charged with Governance 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; 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.

In preparing the financial statements, management is responsible for assessing ABC Company's ability to continue as a going concern in accordance with accounting principles generally accepted in the United States of America, and using the going concern basis of accounting unless management either intends to liquidate ABC Company or to cease operations, or has no realistic alternative but to do so.

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

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

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS 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 taken on the basis of these financial statements.

As part of an audit in accordance with GAAS, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated 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.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control.<sup>5</sup> Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as the overall presentation of the consolidated financial statements.
- Conclude on ABC Company's ability to continue as a going concern and conclude on the appropriateness of management's use of the going concern basis of accounting.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies and material weaknesses in internal control that we identified during our audit.

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

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

[Signature of the auditor's firm]

[Auditor's city and state]

[Date of the auditor's report]

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<sup>5</sup> In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances." In addition, the next sentence, "Accordingly, we express no such opinion." would not be included.

Illustration 32 — An Auditor’s Report With an Other-Matter Paragraph That May Be Appropriate When an Auditor Issues an Updated Report on the Financial Statements of a Prior Period That Contains an Opinion Different From the Opinion Previously Expressed

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). [The audit is not a group audit.](#)
- The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America.
- The terms of the audit engagement reflect the description of management’s responsibility for the financial statements in AU-C section 210.
- The auditor’s report on the prior period financial statements expressed an adverse opinion due to identified departures from accounting principles generally accepted in the United States of America that resulted in the financial statements being materially misstated. The entity has elected to change its method of accounting for the matters that gave rise to the adverse opinion in the prior period, and has restated the prior period financial statements. Therefore, the auditor has expressed an unmodified opinion on the comparative financial statements.
- The auditor’s report includes an other-matter paragraph indicating that the updated report on the financial statements of the prior period contains an opinion different from the opinion previously expressed, as required by proposed SAS, ~~section 700~~, *Forming an Opinion and Reporting on Financial Statements*.
- Although the entity changed its method of accounting for the matters that gave rise to the adverse opinion in the prior period, the principal objective of the communication in the other-matter paragraph is to draw users’ attention to the change in the auditor’s opinion on the prior period financial statements. The other-matter paragraph also refers to the change in accounting principle and the related disclosure in the financial statements. Therefore, the other-matter paragraph also meets the objective of communicating the change in accounting principle as required by AU-C section 708, *Consistency of Financial Statements*, and a separate emphasis-of-matter paragraph is not considered necessary.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time in accordance with AU-C section 570.
- The auditor has obtained all of the other information prior to the date of the auditor’s report and has not identified a material misstatement of the other information.

- The auditor is not communicating key audit matters in the auditor’s report.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.

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

[Appropriate Addressee]

#### **Report on the Audit of the Financial Statements<sup>6</sup>**

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

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

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

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

We conducted our audits 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 independent of ABC Company in accordance with ethical requirements that are relevant to our audit of the financial statements and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence that we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

##### **Other Matter**

In our report dated March 1, 20X1, we expressed an opinion that the 20X0 financial statements did not fairly present the financial position, results of operations, and cash flows of ABC Company in accordance with accounting principles generally accepted in the United States of America because of two departures from such principles: (1) ABC Company carried its property, plant, and equipment at appraisal values, and provided for depreciation on the basis of such values, and (2) ABC Company did not provide for deferred income taxes with respect to differences between income for financial reporting purposes and taxable income. As described in Note X, the Company has changed its method of accounting for these

<sup>6 6</sup> The subtitle “Report on the Financial Statements” is unnecessary in circumstances when the second subtitle “Report on Other Legal and Regulatory Requirements” is not applicable.

items and restated its 20X0 financial statements to conform with accounting principles generally accepted in the United States of America. Accordingly, our present opinion on the restated 20X0 financial statements, as presented herein, is different from that expressed in our previous report.

**Other Information for 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 proposed SAS, The Auditor’s Responsibilities Relating to Other Information Included in Annual Reports – see Illustration 1 in appendix of proposed SAS, The Auditor’s Responsibilities Relating to Other Information Included in Annual Reports.]

**Responsibilities of Management’s Responsibility and Those Charged With Governance for the Financial Statements**

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

In preparing the financial statements, management is responsible for assessing ABC Company’s ability to continue as a going concern in accordance with accounting principles generally accepted in the United States of America, and using 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 y**

~~Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.~~

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. 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 taken on the basis of these financial statements.

As part of an audit in accordance with GAAS, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess~~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,~~ 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 those risk assessments, the auditor considers~~Obtain an understanding of 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 ABC Company's entity's internal control.<sup>7</sup> Accordingly, ~~we express~~ no such opinion is expressed.
- Evaluate~~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.
- Conclude on ABC Company's ability to continue as a going concern and conclude on the appropriateness of management's use of the going concern basis of accounting.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies and material weaknesses in internal control that we identified during our audit.

~~We believe that the audit evidence that we have obtained is sufficient and appropriate to provide a basis for our audit opinion.~~

#### ***Other Matter***

~~In our report dated March 1, 20X1, we expressed an opinion that the 20X0 financial statements did not fairly present the financial position, results of operations, and cash flows of ABC Company in accordance with accounting principles generally accepted in the United States of America because of two departures~~

<sup>7 7</sup> In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances." In addition, the next sentence, "Accordingly, we express no such opinion." would not be included.

~~from such principles: (1) ABC Company carried its property, plant, and equipment at appraisal values, and provided for depreciation on the basis of such values, and (2) ABC Company did not provide for deferred income taxes with respect to differences between income for financial reporting purposes and taxable income. As described in Note X, the Company has changed its method of accounting for these items and restated its 20X0 financial statements to conform with accounting principles generally accepted in the United States of America. Accordingly, our present opinion on the restated 20X0 financial statements, as presented herein, is different from that expressed in our previous report.~~

### Report on Other Legal and Regulatory Requirements

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

~~[~~Auditor's~~Signature of the auditor's firm]~~

~~[Auditor's city and state]~~

~~[Date of the auditor's report]~~

Illustration ~~43~~ — An Auditor’s Report With a Qualified Opinion Due to a Material Misstatement of the Financial Statements and an Emphasis-of-Matter Paragraph Because There Is Uncertainty Relating to a Pending Unusually Important Litigation Matter

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (single year). **The audit is not a group audit.**
- The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America.
- The terms of the audit engagement reflect the description of management’s responsibility for the financial statements in AU-C section 210.
- Inventories are misstated. The misstatement is deemed to be material but not pervasive to the financial statements.
- There is uncertainty relating to a pending unusually important litigation matter.
- The auditor’s report includes a qualified opinion and also includes an emphasis-of-matter paragraph.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time in accordance with AU-C section 570.
- The auditor has obtained all of the other information prior to the date of the auditor’s report and has not identified a material misstatement of the other information.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- The auditor is not communicating key audit matters in the auditor’s report.

## **Independent Auditor's Report**

[Appropriate Addressee]

### **Report on the Audit of the Financial Statements<sup>8</sup>**

#### ***Qualified Opinion***

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

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion ~~section of our report~~~~paragraph~~, the ~~accompanying~~ financial statements ~~referred to above~~ present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

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

The Company has stated inventories at cost in the accompanying balance sheet. Accounting principles generally accepted in the United States of America require inventories to be stated at the lower of cost or market. If the Company stated inventories at the lower of cost or market, a write down of \$XXX would have been required as of December 31, 20X1. Accordingly, cost of sales would have been increased by \$XXX and net income, income taxes, and stockholders' equity would have been reduced by \$XXX, \$XXX, and \$XXX, as of and for the year ended December 31, 20X1, respectively.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 in accordance with ethical requirements that are relevant to our audit of the financial statements and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

#### ***Emphasis of Matter – Litigation***

As discussed in Note X to the financial statements, the Company is a defendant in a lawsuit [*briefly describe the nature of the litigation consistent with the Company's description in the note to the financial statements*]. Our opinion is not modified with respect to this matter.

<sup>8 8</sup> The subtitle "Report on the Financial Statements" is unnecessary in circumstances when the second subtitle "Report on Other Legal and Regulatory Requirements" is not applicable.

*Other Information for 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 proposed SAS, The Auditor’s Responsibilities Relating to Other Information Included in Annual Reports – see Illustration 1 in appendix of proposed SAS, The Auditor’s Responsibilities Relating to Other Information Included in Annual Reports.]*

*Responsibilities of Management and Those Charged With Governance’s Responsibility for the Financial Statements*

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

*In preparing the financial statements, management is responsible for assessing ABC Company’s ability to continue as a going concern in accordance with accounting principles generally accepted in the United States of America, and using 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 responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.*~~

*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. 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 taken on the basis of these financial statements.*

*As part of an audit in accordance with GAAS, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:*

- ~~Identify and assess~~ 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, 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.
- ~~Obtain an understanding of~~ 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 ABC Company's the entity's internal control.<sup>9</sup> Accordingly, ~~we express~~ no such opinion is expressed.
- ~~Evaluate~~ 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.
- Conclude on ABC Company's ability to continue as a going concern and conclude on the appropriateness of management's use of the going concern basis of accounting.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies and material weaknesses in internal control that we identified during our audit.

~~We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.~~

### ***Emphasis of Matter***

~~As discussed in Note X to the financial statements, the Company is a defendant in a lawsuit [briefly describe the nature of the litigation consistent with the Company's description in the note to the financial statements]. Our opinion is not modified with respect to this matter.~~

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

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<sup>9</sup> <sup>9</sup> In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances." In addition, the next sentence, "Accordingly, we express no such opinion." would not be included.

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

*[~~Auditor's~~Signature of the auditor's firm]*

*[Auditor's city and state]*

*[Date of the auditor's report]*