



**Agenda Item 1C (marked)**

**Proposed Statement on Auditing Standards (SAS), *Modifications to the Opinion in the Independent Auditor's Report***

Requirements	Application and Other Explanatory Material
<b>Introduction</b>	
<b>Scope of this Proposed SAS</b>	
<p>1. This proposed statement on auditing standards (SAS) addresses the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with proposed <del>SAS</del><u>AU-C section 700</u>, <i>Forming an Opinion and Reporting on Financial Statements</i> the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary. This proposed SAS also deals with how the form and content of the auditor's report is affected when the auditor expresses a modified opinion. In all cases, the reporting requirements in proposed <u>SAS, <i>Forming an Opinion and Reporting on Financial Statements</i></u><del>AU-C section 700</del> apply, and are not repeated in this proposed SAS unless they are explicitly addressed or amended by the requirements of this proposed SAS.</p>	
	<b>Types of Modified Opinions</b> (Ref: par. 2)

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<p>2. This proposed SAS establishes three types of modified opinions, namely, a qualified opinion, an adverse opinion, and a disclaimer of opinion. The decision regarding which type of modified opinion is appropriate depends upon the following:</p>	
<p>a. The nature of the matter giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated; and</p>	
<p>b. The auditor’s judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements. (Ref: par. A1)</p>	<p>A1. The following table illustrates how the auditor’s professional judgment about the nature of the matter giving rise to the modification, and the pervasiveness of its effects or possible effects on the financial statements, affects the type of opinion to be expressed:</p>

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	<i>Nature of Matter Giving Rise to the Modification</i>	<i>Auditor's Professional Judgment About the Pervasiveness of the Effects or Possible Effects on the Financial Statements</i>	
		<i>Material but Not Pervasive</i>	<i>Material and Pervasive</i>
	Financial statements are materially misstated	Qualified opinion	Adverse opinion
	Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion
3. Proposed <del>SAS, AU C section 706, Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report</del> , and proposed <del>SASAU C section 701, Communicating Key Audit Matters in the Independent Auditor's Report</del> address additional communications in the auditor's report that are not modifications to the auditor's opinion.			
4. This proposed SAS is effective for audits of financial statements for periods ending on or after December 15, 20XX.			

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<b>Objective</b>	
5. The objective of the auditor is to express clearly an appropriately modified opinion on the financial statements that is necessary when:	
a. The auditor concludes, based on the audit evidence obtained, that the financial statements as a whole are materially misstated or	
b. The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.	
<b>Definitions</b>	
6. For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:	
(a) Pervasive – A term used, in the context of misstatements, to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate audit evidence. Pervasive effects on the financial statements are those that, in the auditor’s judgment:	
a. Are not confined to specific elements, accounts or items of the financial statements;	

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<p>b. If so confined, represent or could represent a substantial proportion of the financial statements; or</p>	
<p>c. with regard to disclosures, are fundamental to users' understanding of the financial statements.</p>	
<p>(b) Modified opinion – A qualified opinion, an adverse opinion or a disclaimer of opinion on the financial statements.</p>	
<p><b>Requirements</b></p>	
<p><b>Circumstances When a Modification to the Auditor's Opinion Is Required</b></p>	<p><b>Circumstances When a Modification to the Auditor's Opinion Is Required</b></p>
<p>7. The auditor should modify the opinion in the auditor's report when</p>	

<p>a. the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are materially misstated or (Ref: par. A2-<del>A7A7A9</del>)</p>	<p><i>Nature of Material Misstatements</i> (Ref: par. 7a)</p> <p>A2. Proposed <u>SAS, <i>Forming an Opinion and Reporting on Financial Statements</i></u><del>AU-C section 700</del> requires the auditor, in order to form an opinion on the financial statements, to conclude whether reasonable assurance has been obtained about whether the financial statements as a whole are free from material misstatement.<sup>1</sup> This conclusion takes into account the auditor’s evaluation of uncorrected misstatements, if any, on the financial statements in accordance with AU-C section 450, <i>Evaluation of Misstatements Identified During the Audit</i>.</p>
	<p>A3. AU-C section 450 defines a <i>misstatement</i> as a difference between the <b>reported</b> amount, classification, presentation, or disclosure of a <b>reported</b> financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Accordingly, a material misstatement of the financial statements may arise in relation to the following</p> <ul style="list-style-type: none"> <li>a. The appropriateness of the selected accounting policies;</li> <li>b. The application of the selected accounting policies</li> <li>c. The appropriateness of the financial statement presentation, or the appropriateness or adequacy of disclosures in the financial statements.</li> </ul>

<sup>1</sup> Proposed AU-C section 700, paragraph 11

	<p>Appropriateness of the Selected Accounting Policies</p> <p>A4. <u>With regard</u> <del>In relation</del> to the appropriateness of the accounting policies management has selected, material misstatements of the financial statements may arise, <u>for example</u>, when</p> <ul style="list-style-type: none"><li>a. the selected accounting policies are not consistent with the applicable financial reporting framework; or</li><li>b. The financial statements do not correctly describe an accounting policy relating to a significant item in the statement of financial position, the statement of comprehensive income, the statement of changes in equity or the statement of cash flows; or</li><li>c. the financial statements, <del>including the related notes</del>, do not represent or disclose the underlying transactions and events in a manner that achieves fair presentation.</li></ul>
	<p>A5. Financial reporting frameworks often contain requirements for the accounting for, and disclosure of, changes in accounting policies. <del>When</del> the entity has changed its selection of significant accounting policies, a material misstatement of the financial statements may arise when the entity has not complied with these requirements. If a change in accounting policy does not meet the conditions described in AU-C section 708, <i>Consistency of Financial Statements</i>, then a material misstatement of the financial statements may arise.</p>

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	<p>Application of the Selected Accounting Policies</p> <p>A6. <u>With regard</u> <del>In relation</del> to the application of the selected accounting policies, material misstatements of the financial statements may arise</p> <ul style="list-style-type: none"> <li>a. when management has not applied the selected accounting policies consistently with the financial reporting framework, including when management has not applied the selected accounting policies consistently between periods or to similar transactions and events (consistency in application) or</li> <li>b. due to the method of application of the selected accounting policies (such as an unintentional error in application).</li> </ul>
	<p>Appropriateness of the Financial Statement Presentation or Appropriateness or Adequacy of Disclosures in the Financial Statements</p>
	<p>A7. <u>With regard</u> <del>In relation</del> to the appropriateness of the financial statement presentation or the appropriateness or adequacy of disclosures in the financial statements, material misstatements of the financial statements may arise when</p>
	<ul style="list-style-type: none"> <li>a. the financial statements do not include all of the disclosures required by the applicable financial reporting framework;</li> </ul>
	<ul style="list-style-type: none"> <li>b. the disclosures in the financial statements are not presented in accordance with the applicable financial reporting framework;</li> </ul>



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	<p>c. the financial statements do not provide the additional disclosures necessary to achieve fair presentation beyond disclosures specifically required by the applicable financial reporting framework. Paragraph A19a of AU-C section 450 provides further examples of material misstatements in qualitative disclosures that may arise, or</p>
	<p>d. information required to be presented in accordance with the applicable financial reporting framework is omitted either because a required statement (for example, a statement of cash flows) has not been included or the information has not otherwise been disclosed in the financial statements.</p>
	<p>A8. <del>A27. <del>dequate</del></del> Adequate disclosures relate to the form, arrangement, and content of the financial statements and their related notes, including, for example, the terminology used, the amount of detail given, the classification of items in the statements, and the bases of amounts set forth. An auditor may consider the disclosure of a particular matter in light of the circumstances and facts of which the auditor is aware at the time.</p>

	<p>A9. <del>A28.</del> <u>In considering the adequacy of disclosure, and in other aspects of the audit, the auditor uses information received in confidence from management. Without such confidence, the auditor would find it difficult to obtain information necessary to form an opinion on the financial statements. The “Confidential Client Information Rule” (ET sec. 1.700.001) of the AICPA Code of Professional Conduct states that the auditor should not disclose any confidential client information without the specific consent of the client. Accordingly, the auditor may not make available, without management’s consent, information that is not required to be disclosed in the financial statements to comply with the applicable financial reporting framework.</u></p>
<p>b. the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement. (Ref: par. <del>A10A8–A14A12</del>)</p>	<p>Nature of an Inability to Obtain Sufficient Appropriate Audit Evidence (Ref: Para. 7b)</p> <p>A10. <del>A8.</del> The auditor’s inability to obtain sufficient appropriate audit evidence (also referred to as a limitation on the scope of the audit) may arise from the following</p> <ul style="list-style-type: none"> <li>a. Circumstances beyond the control of the entity;</li> <li>b. Circumstances relating to the nature or timing of the auditor’s work</li> <li>c. Limitations imposed by management.</li> </ul>

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	<p>A11. <del>A9.</del>—An inability to perform a specific procedure does not constitute a limitation on the scope of the audit if the auditor is able to obtain sufficient appropriate audit evidence by performing alternative procedures. If this is not possible, the requirements in paragraphs 8b and 10 apply as appropriate. Limitations imposed by management may have other implications for the audit, such as for the auditor’s assessment of risks of material misstatement due to fraud and consideration of engagement continuance.</p>
	<p>A12. <del>A10.</del>—Examples of circumstances beyond the control of the entity include the following:</p> <ul style="list-style-type: none"> <li>• The entity’s accounting records have been destroyed.</li> <li>• The accounting records of a significant component have been seized indefinitely by governmental authorities.</li> </ul>
	<p>A13. <del>A11.</del>—Examples of circumstances relating to the nature or timing of the auditor’s work include the following:</p> <ul style="list-style-type: none"> <li>• The entity is required to use the equity method of accounting for an associated entity, and the auditor is unable to obtain sufficient appropriate audit evidence about the latter’s financial information to evaluate whether the equity method has been appropriately applied.</li> </ul>
	<ul style="list-style-type: none"> <li>• The timing of the auditor’s appointment is such that the auditor is unable to observe the counting of the physical inventories, and the auditor is unable to <u>obtain sufficient appropriate audit evidence through other appropriate procedures, such as performing a rollback of inventory</u> <del>perform a rollback of the inventory or other appropriate procedures.</del></li> </ul>

	<ul style="list-style-type: none"> <li>The auditor determines that performing substantive procedures alone is not sufficient, but the entity's controls are not effective.</li> </ul>
	<p>A14. <del>A12.</del> Examples of an inability to obtain sufficient appropriate audit evidence arising from a limitation on the scope of the audit imposed by management include the following:</p> <ul style="list-style-type: none"> <li>Management prevents the auditor from observing the counting of the physical inventory.</li> <li>Management prevents the auditor from requesting external confirmation of specific account balances.</li> </ul>
<b>Determining the Type of Modification to the Auditor's Opinion</b>	
<i>Qualified Opinion</i>	
8. The auditor should express a qualified opinion when	
a. the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material but not pervasive to the financial statements or	
b. the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.	

<p><b>Adverse Opinion</b></p>	
<p>9. The auditor should express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.</p>	
<p><i>Disclaimer of Opinion</i></p>	<p><b>Determining the Type of Modification to the Auditor’s Opinion</b></p>
<p>10. The auditor should disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive. (Ref. par. <u>A15A13–A16A14</u>)</p>	<p><b><i>Effect of Uncertainties (Ref: par. 10 )</i></b>  <del>A15. A13. Conclusive audit evidence concerning the ultimate outcome of uncertainties cannot be expected to exist at the time of the audit because the outcome and related audit evidence are prospective. In these circumstances, management is responsible for estimating the effect of future events on the financial statements or determining that a reasonable estimate cannot be made and making the required disclosures, all in accordance with the applicable financial reporting framework, based on management’s analysis of existing conditions. An audit includes an assessment of whether the audit evidence is sufficient to support management’s analysis. Absence of the existence of information related to the outcome of an uncertainty does not necessarily lead to a conclusion that the audit evidence supporting management’s assertion is not sufficient. Rather, the auditor’s professional judgment regarding the sufficiency of the audit evidence is based on the audit evidence that is, or should be, available. If, after considering the existing conditions and available evidence, the auditor concludes that sufficient appropriate audit evidence supports management’s assertions about the nature of a matter involving an uncertainty and its presentation or disclosure in the financial statements, an unmodified opinion ordinarily is appropriate.</del></p>

	<p>A16. <del>A14.</del> In cases involving multiple uncertainties, <u>even if the auditor has obtained sufficient appropriate audit evidence about each of the individual uncertainties</u>, the auditor may conclude that it is not possible to form an opinion on <u>whether</u> the financial statements as a whole are <u>fairly presented in accordance with the applicable financial reporting framework</u> due to the interaction and possible cumulative effects of the uncertainties.</p>
<p><i>Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management-Imposed Limitation After the Auditor Has Accepted the Engagement</i></p>	
<p>11. If, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor should request that management remove the limitation.</p>	
<p>12. If management refuses to remove the limitation referred to in paragraph 11, the auditor should communicate the matter to those charged with governance, unless all of those charged with governance are involved in managing the entity,<sup>2</sup> and determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence.</p>	
<p>13. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor should determine the implications as follows:</p>	

<sup>2</sup> Paragraph .09 of AU-C 260, The Auditor's Communication with Those Charged with Governance

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<p>a. If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor should qualify the opinion; or</p>	
<p>b. If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the <del>severity</del><u>gravity</u> of the situation, the auditor should:</p>	
<p>i. Disclaim an opinion on the financial statements; or</p>	
<p>ii. Withdraw from the audit, when practicable (Ref: par. <del>A17A15</del><u>A18A16</u>)</p>	<p><b>Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management-Imposed Limitation after the Auditor Has Accepted the Engagement (Ref: <del>par. 14</del><u>13</u>)</b></p> <p>A17. <del>A15</del>-The practicality of withdrawing from the audit may depend on the stage of completion of the engagement at the time that management imposes the scope limitation. If the auditor has substantially completed the audit, the auditor may decide to complete the audit to the extent possible, disclaim an opinion and explain the scope limitation within the <u>B</u>asis for <u>D</u>isclaimer of <u>O</u>pinion section.</p>

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<p>14. If the auditor withdraws as contemplated by paragraph 13, before withdrawing, the auditor should communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion. (Ref: par. <del>A18</del>A16)</p>	<p>A18. <del>A16</del>-In certain circumstances, withdrawal from the audit may not be possible if the auditor is required by law or regulation to continue the audit engagement. This may be the case for an auditor who is appointed to audit the financial statements of governmental entities. It may also be the case in circumstances when the auditor is appointed to audit the financial statements covering a specific period, or appointed for a specific period and is prohibited from withdrawing before the completion of the audit of those financial statements or before the end of that period, respectively. In these circumstances, the auditor may also consider it necessary to include an other-matter paragraph in the auditor's report.<sup>3</sup></p>
<p><i>Other Considerations Relating to an Adverse Opinion or Disclaimer of Opinion</i></p>	<p><b><i>Other Considerations Relating to an Adverse or Disclaimer of Opinion (Ref: par. 15)</i></b></p>

<sup>3</sup> Paragraph .XX of proposed ~~SAS, AU-C section 706,~~ *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*



<p>15. When the auditor considers it necessary to express an adverse opinion or disclaim an opinion on the financial statements as a whole, the auditor's report should not also include an unmodified opinion with respect to the same financial reporting framework on a single financial statement or one or more specific elements, accounts or items of a financial statement (<u>piecemeal opinion</u>). To include such an unmodified opinion in the same report<sup>4</sup> in these circumstances would contradict the auditor's adverse opinion or disclaimer of opinion on the financial statements as a whole. (Ref: par. <del>A19.a</del><del>A17</del><del>A20</del>A18)</p>	<p>A19. <del>A17</del>. <u>The following are examples of reporting circumstances that would not contradict the auditor's adverse opinion or disclaimer of opinion:</u></p> <p>a. In an initial audit, <del>it is acceptable for the auditor to</del> <u>expression of</u> an unmodified opinion regarding the financial position and <u>a disclaimer of</u> <del>an</del> opinion regarding the results of operations, and cash flows, when relevant. In this case, the auditor has not disclaimed an opinion on the financial statements as a whole.</p>
	<p>b. <u>The expression of an unmodified opinion on financial statements prepared under a given financial reporting framework and, within the same report, the expression of an adverse opinion on the same financial statements under a different financial reporting framework.</u><sup>5</sup></p>

<sup>4</sup> AU-C section ISA-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 ~~deals with circumstances where the auditor is engaged to express a separate opinion on one or more specific elements, accounts or items of a financial statement.~~

<sup>5</sup> ~~See paragraph A31 of ISA 700 (Revised) for a description of this circumstance.~~

	<p><i>Considerations Specific to Audits of Governmental Entities</i></p> <p>A20. <del>A18.</del> Because the auditor of a state and local government entity expresses an opinion or disclaims an opinion for each opinion unit,<sup>6</sup> an auditor’s report in these circumstances may include an unmodified opinion with respect to one or more opinion units and a modified opinion for one or more other opinion units.</p>
<p><b><i>Auditor Is Not Independent but Is Required by Law or Regulation to Report on the Financial Statements</i></b></p>	<p><b><u><i>Auditor Is Not Independent but Is Required by Law or Regulation to Report on the Financial Statements</i></u></b></p>
<p>16. When the auditor is not independent but is required by law or regulation to report on the financial statements, the auditor should disclaim an opinion and should specifically state that the auditor is not independent. The auditor is neither required to provide, nor precluded from providing, the reasons for the lack of independence; however, if the auditor chooses to provide the reasons for the lack of independence, the auditor should include all the reasons therefor. (Ref: par. <u>A21A19</u>)</p>	<p><i>Considerations Specific to Governmental Entities</i></p> <p>A21. <del>A19.</del>—The nature of a government auditor’s lack of independence may have a limited effect because the impairment may result from the government auditor’s association with only a component of the overall governmental entity. A government auditor may determine that the lack of independence only affects one or more, but not all, of the governmental entity’s opinion units and, in such circumstances, the auditor may disclaim an opinion on the affected opinion units while expressing unmodified, qualified, or adverse opinions on other opinion units. The more significant the affected opinion units are to the overall governmental entity, the more likely that it will be appropriate for the auditor to disclaim an opinion on the financial statements of the overall governmental entity.</p>

<sup>6</sup> Paragraph ~~A54~~ of proposed SAS, *Forming an Opinion and Reporting on Financial Statements* section 700.

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Form and Content of the Auditor's Report When the Opinion Is Modified	Form and Content of the Auditor's Report When the Opinion Is Modified
<i>Auditor's Opinion</i>	
17. When the auditor modifies the audit opinion, the auditor should use the heading "Qualified Opinion," "Adverse Opinion," or "Disclaimer of Opinion," as appropriate, for the <u>O</u> pinion section. (Ref: par. <del>A22A20</del> <del>A24A22</del> )	<b><i>Illustrative Auditor's Reports (Ref: par. 17)</i></b> A22. <del>A20</del> —Illustrations 1 and <del>32</del> in the exhibit contain auditor's reports with qualified and adverse opinions, respectively, as the financial statements are materially misstated.
	A23. <del>A21</del> —Illustration <del>43</del> in the exhibit contains an auditor's report with a qualified opinion as the auditor is unable to obtain sufficient appropriate audit evidence. Illustration <del>54</del> contains a disclaimer of opinion due to an inability to obtain sufficient appropriate audit evidence about a single element of the financial statements. Illustration <del>65</del> contains a disclaimer of opinion due to an inability to obtain sufficient appropriate audit evidence about multiple elements of the financial statements. In each of the latter two cases, the possible effects on the financial statements of the inability are both material and pervasive. The exhibits to other AU-C sections that include reporting requirements, <del>including AU-C section 570</del> also include illustrations of auditor's reports with modified opinions.
	<b><i>Auditor's Opinion (Ref: par. 17)</i></b> A24. <del>A22</del> —Amending the heading required by paragraph 17 makes it clear to the user that the auditor's opinion is modified and indicates the type of modification.
Qualified Opinion	Qualified Opinion (Ref: par. 18)

<p>18. When the auditor expresses a qualified opinion due to a material misstatement in the financial statements, the auditor should state that, in the auditor’s opinion, except for the effects of the matter(s) described in the <u>B</u>asis for <u>Q</u>ualified <u>O</u>pinion section, the accompanying financial statements present fairly, in all material respects, [...] in accordance with [the applicable financial reporting framework]. When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor should use the corresponding phrase “except for the possible effects of the matter(s) ...” for the modified opinion. (Ref: par. <del>A25A23–A26A24</del>)</p>	<p>A25. <del>A23</del>–When the auditor expresses a qualified opinion, it would not be appropriate to use phrases such as <i>with the foregoing explanation</i> or <i>subject to</i> in the <u>O</u>pinion section because these are not sufficiently clear or forceful. Because accompanying notes are part of the financial statements, wording such as "fairly presented, in all material respects, when read in conjunction with note 1" is likely to be misunderstood and would also not be appropriate.</p>
	<p>A26. <del>A24</del>–When the auditor expresses a qualified opinion due to a scope limitation, paragraph 18 requires that the auditor state in the opinion paragraph that the qualification pertains to the possible effects of the matter on the financial statements and not to the scope limitation itself. Wording such as "In our opinion, except for the above-mentioned limitation on the scope of our audit ..." bases the exception on the restriction itself rather than on the possible effects on the financial statements and, therefore, is unacceptable.</p>
<p>Adverse Opinion</p>	
<p>19. When the auditor expresses an adverse opinion, the auditor should state that, in the auditor’s opinion, because of the significance of the matter(s) described in the <u>B</u>asis for <u>A</u>dvverse <u>O</u>pinion section the accompanying financial statements do not present fairly, <del>in all material respects</del>, [...] in accordance with [the applicable financial reporting framework].</p>	
<p>Disclaimer of Opinion</p>	

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<p>20. When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor should</p>	
<p>a. state that the auditor does not express an opinion on the accompanying financial statements and</p>	
<p>b. state that, because of the significance of the matter(s) described in the <u>B</u>asis for <u>D</u>isclaimer of <u>O</u>pinion section, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements; and</p>	
<p>c. amend the statement required by paragraph 23(b) of proposed <u>SAS, Forming an Opinion and Reporting on Financial Statements</u>, <del>AU C section 700</del>, which indicates that the financial statements have been audited, to state that the auditor was engaged to audit the financial statements.</p>	
<p><b><i>Basis for Opinion</i></b></p>	<p><b><i>Basis for Opinion (Ref: par. 21, 22, 24, 28)</i></b></p>
<p>21. When the auditor modifies the opinion on the financial statements, the auditor should, in addition to the specific elements required by proposed <u>SAS, Forming an Opinion and Reporting on Financial Statements</u>, <del>AU C section 700</del> (Ref: par. <u>A27</u><del>A25</del>)</p>	<p>A27. <del>A25</del>—Consistency in the auditor’s report helps promote users’ understanding and identify unusual circumstances when they occur. Accordingly, although uniformity in the wording of a modified opinion and the description of the reasons for the modification may not be possible, consistency in both the form and content of the auditor’s report is desirable.</p>

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<p><i>a.</i> <del>a</del> Amend the heading “Basis for Opinion” required by paragraph 26 of proposed <u>SAS, Forming an Opinion and Reporting on Financial Statements</u>, <del>AU-C section 700</del> to “Basis for Qualified Opinion,” “Basis for Adverse Opinion,” or “Basis for Disclaimer of Opinion,” as appropriate; and</p>	
<p><i>b.</i> <del>w</del> Within this section, include a description of the matter giving rise to the modification.</p>	
<p>22. If there is a material misstatement of the financial statements that relates to specific amounts in the financial statements (including quantitative disclosures), the auditor should include in the <del>B</del><u>o</u>asis for <del>o</del><u>o</u>pinion section a description and quantification of the financial effects of the misstatement, unless impracticable. If it is not practicable to quantify the financial effects, the auditor should so state in this section. (Ref: par. <del>A28</del><u>A26</u>)</p>	<p>A28. <del>A26</del>. An example of the financial effects of misstatements that the auditor may describe within the <del>B</del><u>o</u>asis for <del>O</del><u>o</u>pinion section in the auditor’s report is the quantification of the effects on income before taxes, income taxes, net income and equity if inventory is overstated. If such disclosures are made in a note to the financial statements, the <del>B</del><u>o</u>asis for <del>M</del><u>o</u>modified <del>O</del><u>o</u>pinion section may refer to the note.</p>
	<p><del>A27. Adequate disclosures relate to the form, arrangement, and content of the financial statements and their related notes, including, for example, the terminology used, the amount of detail given, the classification of items in the statements, and the bases of amounts set forth. An auditor may consider the disclosure of a particular matter in light of the circumstances and facts of which the auditor is aware at the time.</del></p>

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	<p><del>A28. In considering the adequacy of disclosure, and in other aspects of the audit, the auditor uses information received in confidence from management. Without such confidence, the auditor would find it difficult to obtain information necessary to form an opinion on the financial statements. The “Confidential Client Information Rule” (ET sec. 1.700.001) of the AICPA Code of Professional Conduct states that the auditor should not disclose any confidential client information without the specific consent of the client. Accordingly, the auditor may not make available, without management’s consent, information that is not required to be disclosed in the financial statements to comply with the applicable financial reporting framework.</del></p>
<p>23. If there is a material misstatement of the financial statements that relates to <del>qualitative narrative</del> disclosures, the auditor should include in the <u>B</u>asis for <u>O</u>pinion section an explanation of how the disclosures are misstated.</p>	
<p>24. If there is a material misstatement of the financial statements that relates to the omission of information required to be presented or disclosed, the auditor should</p>	
<p>a. discuss the omission of such information with those charged with governance;</p>	
<p>b. describe in the <u>B</u>asis for <u>O</u>pinion section the nature of the omitted information; and</p>	

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<p>c. include the omitted information, provided that it is practicable to do so and the auditor has obtained sufficient appropriate audit evidence about the omitted information. (Ref: par. A29–A30)</p>	<p>A29. <del>A29.</del> <i>Practicable</i>, as used in the context of paragraphs 22 and 24c, means that the information is reasonably obtainable from management’s accounts and records and that providing the information in the report does not require the auditor to assume the position of a preparer of financial information. For example, the auditor would not be expected to prepare a basic financial statement or segment information and include it in the auditor’s report when management omits such information.</p>
	<p>A30. <del>A30.</del> Disclosing the omitted information within the <u>B</u>asis for <u>O</u>pinion section would not be practicable if</p> <ul style="list-style-type: none"> <li>a. The information has not been prepared by management or the information is otherwise not readily available to the auditor; or</li> <li>b. In the auditor’s judgment, the information would be unduly voluminous in relation to the auditor’s report.</li> </ul>
<p>25. If the modification results from an inability to obtain sufficient appropriate audit evidence, the auditor should include in the <u>B</u>asis for <u>O</u>pinion section the reasons for that inability. (Ref. Par. A31)</p>	<p>A31. <del>A31.</del> When the auditor modifies the opinion due to an inability to obtain sufficient appropriate audit evidence, it is not appropriate for the scope of the audit to be explained in a note to the financial statements because the description of the audit scope is the responsibility of the auditor and not that of management.</p>
<p>26. When the auditor expresses a qualified or an adverse opinion, the auditor should amend the statement about whether the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor’s opinion required by paragraph 26(d) of proposed <u>SAS, Forming an Opinion and Reporting on Financial Statements</u>, <del>AU-C section 700</del> to include the word “qualified” or “adverse”, as appropriate.</p>	



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<p>27. When the auditor disclaims an opinion on the financial statements, the auditor’s report should not include the elements required by paragraphs 26(b) and 26(d) of proposed <u>SAS Forming an Opinion and Reporting on Financial Statements</u><del>AU-C section 700</del>. Those elements are</p>	
<p>a. a reference to the section of the auditor’s report where the auditor’s responsibilities are described; and</p>	
<p>b. A statement about whether the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor’s opinion.</p>	
<p>28. Even if the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements, the auditor should describe in the <u>B</u>asis for <u>O</u>pinion section the reasons for any other matters of which the auditor is aware that would have required a modification to the opinion, and the effects thereof. (Ref: par. A32–A33)</p>	<p>A32. <del>A32.</del> An adverse opinion or a disclaimer of opinion relating to a specific matter described within the <u>B</u>asis for <u>O</u>pinion section does not justify the omission of a description of other identified matters that would have otherwise required a modification of the auditor’s opinion. In such cases, the disclosure of such other matters of which the auditor is aware may be relevant to users of the financial statements.</p>
	<p>A33. <del>A33.</del> The auditor may consider whether there is a need to describe in an emphasis-of-matter or other-matter paragraph(s)<sup>7</sup> any other matters of which the auditor is aware that would <u>not</u> require a modification of the auditor’s opinion <del>that would have resulted in additional communication in the auditor’s report on the financial statements.</del></p>

<sup>7</sup>See proposed SAS, AU-C section 706, Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor’s Report.

<b>Description of Auditor’s Responsibilities for the Audit of the Financial Statements When the Auditor Disclaims an Opinion on the Financial Statements</b>	<b><i>Description of Auditor’s Responsibilities for the Audit of the Financial Statements When the Auditor Disclaims an Opinion on the Financial Statements (Ref: par. 29)</i></b>
<p>29. When the auditor disclaims an opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence, the auditor should amend the description of the auditor’s responsibilities required by paragraphs 35–37 of proposed <u>SAS, Forming an Opinion and Reporting on Financial Statements</u>, <del>AU-C section 700</del> to include only the following: (Ref: par. A34)</p>	<p>A34. <del>A34.</del> When the auditor disclaims an opinion on the financial statements, the following statements are better positioned within the Auditor’s Responsibilities for the Audit of the Financial Statements section of the auditor’s report, as illustrated in Illustrations X–Y of the exhibit to this proposed SAS</p> <ul style="list-style-type: none"> <li>• The statement required by paragraph 26(a) of proposed <u>SAS, Forming an Opinion and Reporting on Financial Statements</u>, <del>AU-C section 700</del>, amended to state that the auditor’s responsibility is to conduct an audit of the entity’s financial statements in accordance with auditing standards generally accepted in the United States of America; and</li> <li>• The statement required by paragraph 26(c) of proposed <u>SAS, Forming an Opinion and Reporting on Financial Statements</u>, <del>AU-C section 700</del> about independence and other ethical responsibilities.</li> </ul>
<p><i>a.</i> A statement that the auditor’s responsibility is to conduct an audit of the entity’s financial statements in accordance with auditing standards generally accepted in the United States of America and to issue an auditor’s report;</p>	

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<p>b. <del>A</del> statement that, however, because of the matter(s) described in the <del>B</del>asis for <del>D</del>isclaimer of <del>O</del>pinion section, the auditor was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements; and</p>	
<p>c. The statement about auditor independence and other ethical responsibilities required by paragraph 26(c) of proposed <u>SAS, Forming an Opinion and Reporting on Financial Statements</u><del>AU-C section 700</del>.</p>	
<p><i>Considerations When the Auditor Expresses an Adverse Opinion or Disclaims an Opinion on the Financial Statements</i></p>	<p><i>Considerations When the Auditor Issues an Adverse Opinion or Disclaims an Opinion on the Financial Statements (Ref: par. 30)</i></p>

30. When the auditor issues an adverse opinion or disclaims an opinion on the financial statements, the auditor's report should not include a Key Audit Matters section in accordance with proposed SAS, Communicating Key Audit Matters in the Independent Auditor's Report AU-C section 701.<sup>8</sup> (Ref: par. A35–A36)

~~A35. A35-Describing Providing the reasons for the modification of the opinion within the Basis for Opinion section of the auditor's report provides useful information to users in understanding why the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements and may further guard against inappropriate reliance on them. However, providing further details about the audit may overshadow the reasons for the modification of the opinion and potentially may be confusing to users. Accordingly, paragraph 30 of this proposed SAS prohibits the inclusion of a Key Audit Matters section in the auditor's report when the auditor issues an adverse opinion or disclaims an opinion on the financial statements. When the auditor has expressed an adverse opinion, the communication of any key audit matters other than the matter(s) giving rise to the modified opinion may not be relevant to the users because the financial statements as a whole are materially misstated. When the auditor disclaims an opinion, the communication of any key audit matters other than the matter(s) giving rise to the disclaimer of opinion may suggest that the financial statements are more credible in relation to those matters than would be appropriate in the circumstances, and would be inconsistent with the disclaimer of opinion on the financial statements as a whole.~~

<sup>8</sup> Proposed SAS, AU-C 701, Communicating Key Audit Matters in the Independent Auditor's Report, paragraphs .xx–.xx

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	<p><u>A36. When the auditor has expressed an adverse opinion, the communication of any key audit matters other than the matter(s) giving rise to the modified opinion may not be relevant to the users because the financial statements as a whole are materially misstated. When the auditor disclaims an opinion, the communication of any key audit matters other than the matter(s) giving rise to the disclaimer of opinion may suggest that the financial statements are more credible in relation to those matters than would be appropriate in the circumstances, and would be inconsistent with the disclaimer of opinion on the financial statements as a whole. Accordingly, paragraph 30 of this proposed SAS prohibits the inclusion of a Key Audit Matters section in the auditor's report when the auditor issues an adverse opinion or disclaims an opinion on the financial statements.</u></p>
Communication With Those Charged with Governance	Communication with Those Charged with Governance (Ref: par. 31)

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31. When the auditor expects to modify the opinion in the auditor’s report, the auditor should communicate with those charged with governance the circumstances that led to the expected modification and the wording of the modification. (Ref: par. A37A36)

~~A36-A37.~~ A36.—Communicating with those charged with governance the circumstances that lead to an expected modification to the auditor’s opinion and the wording of the modification enables:

- (a) The auditor to give notice to those charged with governance of the intended modification(s) and the reasons (or circumstances) for the modification(s);
- (b) The auditor to seek the concurrence of those charged with governance regarding the facts of the matter(s) giving rise to the expected modification(s), or to confirm matters of disagreement with management as such; and
- (c) Those charged with governance to have an opportunity, when appropriate, to provide the auditor with further information and explanations in respect of the matter(s) giving rise to the expected modification(s).

~~Appendix—(Illustrations not included—to be provided at a future date once the format of proposed AU-C 700 is decided).~~

ISA 705 (Revised)	Extant AU-C 705
<del>Illustration 1: An auditor’s report containing a qualified opinion due to a material misstatement of the financial statements.</del>	Illustration 1: An auditor’s report containing a qualified opinion due to a material misstatement of the financial statements.
	Illustration 2— An Auditor’s Report Containing a Qualified Opinion for Inadequate Disclosure
<del>Illustration 2: An auditor’s report containing an adverse opinion due to a material misstatement of the consolidated financial statements.</del>	Illustration 3— An Auditor’s Report Containing an Adverse Opinion Due to a Material Misstatement of the Financial Statements

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<p><del>Illustration 3: An auditor's report containing a qualified opinion due to the auditor's inability to obtain sufficient appropriate audit evidence regarding a foreign associate.</del></p>	<p><del>Illustration 4 — An Auditor's Report Containing a Qualified Opinion Due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence</del></p>
<p><del>Illustration 4: An auditor's report containing a disclaimer of opinion due to the auditor's inability to obtain sufficient appropriate audit evidence about a single element of the consolidated financial statements.</del></p>	<p><del>Illustration 5 — An Auditor's Report Containing a Disclaimer of Opinion Due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence About a Single Element of the Financial Statements</del></p>
<p><del>Illustration 5: An auditor's report containing a disclaimer of opinion due to the auditor's inability to obtain sufficient appropriate audit evidence about multiple elements of the financial statements.</del></p>	<p><del>Illustration 6 — An Auditor's Report Containing a Disclaimer of Opinion Due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence About Multiple Elements of the Financial Statements</del></p>
	<p><del>Illustration 7 — An Auditor's Report in Which the Auditor Is Expressing an Unmodified Opinion in the Prior Year and a Modified Opinion (Qualified Opinion) in the Current Year</del></p>
	<p><del>Illustration 8 — An Auditor's Report in Which the Auditor Is Expressing an Unmodified Opinion in the Current Year and a Disclaimer of Opinion on the Prior Year Statements of Income, Changes in Stockholders' Equity, and Cash Flows</del></p>

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