



**Agenda Item 1C (Marked)**

**Auditor Reporting — ~~Exposure Draft Marked to Reflect Changes from Comment Letters~~**

**~~PROPOSED~~ STATEMENT ON AUDITING STANDARDS  
MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT**

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

Requirements	Application and Other Explanatory Material
<b>Introduction</b>	
<b>Scope of This <del>Proposed</del> Statement on Auditing Standards</b>	
<p>1. This <del>proposed</del> statement on auditing standards (SAS) addresses the auditor's responsibility to issue an appropriate report in circumstances in which, in forming an opinion in accordance with <del>proposed SAS</del> <a href="#"><u>SASs Forming an Opinion and Reporting on Financial Statements</u></a> <u>or Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA</u>, the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary. This <del>proposed</del> 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 <del>proposed</del> SAS <i>Forming an Opinion and Reporting on Financial Statements</i> <u>or Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA</u>, apply; those requirements are not repeated in this <del>proposed</del> SAS unless they are explicitly addressed or amended by the requirements of this <del>proposed</del> SAS.</p>	

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<b>Types of Modified Opinions</b>	<b>Types of Modified Opinions (Ref: par. 2)</b>										
2. This <del>proposed</del> 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 on the following:											
<i>a.</i> 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											
<i>b.</i> The auditor's judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements (Ref: par. A1)	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:										
	<table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 40%;"></th> <th colspan="2" style="text-align: center;"><i>Auditor's Professional Judgment About the Pervasiveness of the Effects or Possible Effects on the Financial Statements</i></th> </tr> <tr> <th style="text-align: left;"><i>Nature of Matter Giving Rise to the Modification</i></th> <th style="text-align: center;"><i>Material but Not Pervasive</i></th> <th style="text-align: center;"><i>Material and Pervasive</i></th> </tr> </thead> <tbody> <tr> <td>Financial statements are materially misstated</td> <td style="text-align: center;">Qualified opinion</td> <td style="text-align: center;">Adverse opinion</td> </tr> </tbody> </table>			<i>Auditor's Professional Judgment About the Pervasiveness of the Effects or Possible Effects on the Financial Statements</i>		<i>Nature of Matter Giving Rise to the Modification</i>	<i>Material but Not Pervasive</i>	<i>Material and Pervasive</i>	Financial statements are materially misstated	Qualified opinion	Adverse opinion
	<i>Auditor's Professional Judgment About the Pervasiveness of the Effects or Possible Effects on the Financial Statements</i>										
<i>Nature of Matter Giving Rise to the Modification</i>	<i>Material but Not Pervasive</i>	<i>Material and Pervasive</i>									
Financial statements are materially misstated	Qualified opinion	Adverse opinion									

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	Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion
3. <del>Proposed</del> SAS <i>Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report</i> and <del>proposed</del> SAS <i>Communicating Key Audit Matters in the Independent Auditor's Report</i> address additional communications in the auditor's report that are not modifications to the auditor's opinion.			
<b>Effective Date</b>			
4. This <del>proposed</del> SAS <u>will be</u> effective for audits of financial statements for periods ending on or after <del>June 15, 2019.</del> <u>December 15, 2020.</u> Early implementation is not permitted.			
<b>Objective</b>			
5. The objective of the auditor is to express clearly an appropriately modified opinion on the financial statements that is necessary in the following circumstances:			
a. The auditor concludes, based on the audit evidence obtained, that the financial statements as a whole are materially misstated.			

~~\*This effective date is provisional but will not be earlier than June 15, 2019.~~

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<p><i>b.</i> The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.</p>	
<b>Definitions</b>	
<p>6. For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:</p>	
<p><b>Modified opinion.</b> A qualified opinion, an adverse opinion, or a disclaimer of opinion on the financial statements.</p>	
<p><b>Pervasive.</b> 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</p>	
<ul style="list-style-type: none"> <li>• are not confined to specific elements, accounts or items of the financial statements;</li> </ul>	
<ul style="list-style-type: none"> <li>• if so confined, represent or could represent a substantial proportion of the financial statements; or</li> </ul>	
<ul style="list-style-type: none"> <li>• regarding disclosures, are fundamental to users' understanding of the financial statements.</li> </ul>	

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<b>Requirements</b>	
<b>Circumstances in Which a Modification to the Auditor's Opinion Is Required</b>	<b>Circumstances in Which a Modification to the Auditor's Opinion Is Required</b>
7. The auditor should modify the opinion in the auditor's report when	
<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–A8)</p>	<p><i>Nature of Material Misstatements</i> (Ref: par. 7a)</p> <p>A2. <del>Proposed-SAS</del><u>SASs</u> <i>Forming an Opinion and Reporting on Financial Statements</i> <del>requires,</del> <u>and Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA</u> require 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>.<sup>†</sup></p> <p>A3. AU-C section 450 defines a <i>misstatement</i> as a difference between the reported amount, classification, presentation, or disclosure of a 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>• The appropriateness of the selected accounting policies</li> </ul>

<sup>1</sup> Paragraph ~~11~~13 of ~~proposed-SAS~~ *Forming an Opinion and Reporting on Financial Statements* and paragraph 35 of SAS *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*.

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

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	<ul style="list-style-type: none"> <li>• The application of the selected accounting policies</li> <li>• The appropriateness of the financial statement presentation, or the appropriateness or adequacy of disclosures in the financial statements</li> </ul>
	<p><i>Appropriateness of the Selected Accounting Policies</i></p> <p>A4. Regarding the appropriateness of the accounting policies management has selected, material misstatements of the financial statements may arise, for example, when</p> <ul style="list-style-type: none"> <li>• the selected accounting policies are not consistent with the applicable financial reporting framework</li> <li>• the financial statements do not correctly describe an accounting policy relating to a significant item therein; or</li> <li>• the financial statements 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. When the entity has changed its selection of significant accounting policies, a material misstatement of the financial statements may arise when the entity has not complied with these requirements. If a change in accounting policy does not meet the conditions described in AU-C section 708, <i>Consistency of Financial Statements</i>, then a material misstatement of the financial statements may arise.</p>
	<p><i>Application of the Selected Accounting Policies</i></p> <p>A6. Regarding the application of the selected accounting policies, material misstatements of the financial statements may arise</p>

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	<ul style="list-style-type: none"> <li>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).</li> </ul>
	<ul style="list-style-type: none"> <li>due to the method of application of the selected accounting policies (such as an unintentional error in application).</li> </ul>
	<i>Appropriateness of the Financial Statement Presentation or Appropriateness or Adequacy of Disclosures in the Financial Statements</i>
	A7. Regarding 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 the following occur:
	<ul style="list-style-type: none"> <li>The financial statements do not include all the disclosures required by the applicable financial reporting framework.</li> </ul>
	<ul style="list-style-type: none"> <li>The disclosures in the financial statements are not presented in accordance with the applicable financial reporting framework.</li> </ul>
	<ul style="list-style-type: none"> <li>The financial statements do not provide the additional disclosures necessary to achieve fair presentation beyond disclosures specifically required by the applicable financial reporting framework.</li> </ul>
	<ul style="list-style-type: none"> <li>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</li> </ul>

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	<p>cash flows) has not been included or because the information has not otherwise been disclosed in the financial statements.</p> <p>Paragraph .A23 of AU-C section 450 provides further examples of material misstatements that may arise in qualitative disclosures.</p>
	<p>A8. Adequate disclosures relate to the presentation of the financial statements and the 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.</p>
<p><i>b.</i> 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. A9–A13)</p>	<p>Nature of an Inability to Obtain Sufficient Appropriate Audit Evidence (Ref: par. 7<i>b</i>)</p> <p>A9. 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>• Circumstances beyond the control of the entity</li> <li>• Circumstances relating to the nature or timing of the auditor's work</li> <li>• Limitations imposed by management</li> </ul>
	<p>A10. 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 8<i>b</i> 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>

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<b>Requirements</b>	<b>Application and Other Explanatory Material</b>
	<p>A11. 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>A12. 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 investee, 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 obtain sufficient appropriate audit evidence through other appropriate procedures, such as performing a rollback of inventory.</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>A13. 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>

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<b>Determining the Type of Modification to the Auditor's Opinion</b>	
<i>Qualified Opinion</i>	
8. The auditor should express a qualified opinion in the following circumstances:	
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.	
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.	
<i>Adverse Opinion</i>	
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.	
<i>Disclaimer of Opinion</i>	<b>Determining the Type of Modification to the Auditor's Opinion</b>
10. The auditor should disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the	<i>Effect of Uncertainties (Ref: par. 10 )</i>

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<b>Requirements</b>	<b>Application and Other Explanatory Material</b>
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. A14–A15)	A14. 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.
	A15. In cases involving multiple uncertainties, the auditor may conclude that it is not possible to form an opinion on whether the financial statements as a whole are fairly presented in accordance with the applicable financial reporting framework due to the interaction and possible cumulative effects of the uncertainties.
<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>	
11. If, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor should request that management remove the limitation.	
12. If management refuses to remove the limitation referred to in paragraph 11, the auditor should communicate the matter to those charged with governance, unless all of those charged with governance are	

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<b>Requirements</b>	<b>Application and Other Explanatory Material</b>
involved in managing the entity, <sup>2</sup> and, if appropriate, determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence.	
13. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor should determine the implications as follows:	
<i>a.</i> 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.	
<i>b.</i> 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 severity of the situation, the auditor should	
<i>i.</i> disclaim an opinion on the financial statements or	
	<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: par. 13)</b>

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

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<p>ii. withdraw from the audit, when practicable. (Ref: par. A16–A17)</p>	<p>A16. The practicality of withdrawing from the audit may depend on the stage of completion of the engagement at the time that management imposes the scope limitation. If the auditor has substantially completed the audit, the auditor may decide to complete the audit to the extent possible, disclaim an opinion, and explain the scope limitation in the “Basis for Disclaimer of Opinion” section.</p>
<p>14. If the auditor decides to withdraw from the audit in accordance with paragraph <del>13</del>, <u>13(b)(ii)</u>, before doing so, 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. A17)</p>	<p>A17. 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 or elected to audit the financial statements of governmental entities. It may also be the case in circumstances in which the auditor is appointed to audit the financial statements covering a specific period or is 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. In such circumstances, the auditor may 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 Opinion or Disclaimer of Opinion (Ref: par. 15)</i></b></p>
<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 (piecemeal opinion). To include such an unmodified</p>	<p>A18. The following are examples of reporting circumstances that would not contradict the auditor’s adverse opinion or disclaimer of opinion:</p> <ul style="list-style-type: none"> <li>• In an initial audit, the expression of an unmodified opinion regarding the financial position and a disclaimer of 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.</li> </ul>

<sup>3</sup> Paragraphs 10-11 of ~~proposed~~ SAS *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor’s Report*.

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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. A18–A19)	
	<ul style="list-style-type: none"> <li>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.</li> </ul>
	<p><i>Considerations Specific to Audits of Governmental Entities</i></p> <p>A19. Because the auditor of a state and local government entity expresses an opinion or disclaims an opinion for each opinion unit,<sup>5</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>
<b><i>Auditor Is Not Independent but Is Required by Law or Regulation to Report on the Financial Statements</i></b>	<b><i>Auditor Is Not Independent but Is Required by Law or Regulation to Report on the Financial Statements</i></b>
	<i>Considerations Specific to Governmental Entities</i>

<sup>4</sup> AU-C section 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*, addresses special considerations relevant to an audit of a single financial statement or of a specific element, account, or item of a financial statement.

<sup>5</sup> Paragraph A5 of ~~proposed~~ SAS *Forming an Opinion and Reporting on Financial Statements*.

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<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. A20)</p>	<p>A20. 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 affects only 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>
<p><b>Form and Content of the Auditor's Report When the Opinion Is Modified</b></p>	<p><b>Form and Content of the Auditor's Report When the Opinion Is Modified</b></p>
<p><i>Auditor's Opinion</i></p>	
	<p><i>Illustrative Auditor's Reports (Ref: par. 17)</i></p>
<p>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 "Opinion" section. (Ref: par. A21–A23)</p>	<p>A21. Illustrations 1 and 3 in the exhibit to this <del>proposed</del> SAS contain auditor's reports with qualified and adverse opinions, respectively, because the financial statements are materially misstated.</p>

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<b>Requirements</b>	<b>Application and Other Explanatory Material</b>
	A22. Illustration 4 in the exhibit contains an auditor's report with a qualified opinion because the auditor is unable to obtain sufficient appropriate audit evidence. Illustration 5 contains a disclaimer of opinion due to an inability to obtain sufficient appropriate audit evidence about a single element of the financial statements. Illustration 6 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 to obtain sufficient appropriate audit evidence are both material and pervasive. The exhibits to other AU-C sections that include reporting requirements also include illustrations of auditor's reports with modified opinions.
	<i>Auditor's Opinion (Ref: par. 17)</i>
	A23. 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)
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 matters described in the "Basis for Qualified Opinion" 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 matters..." for the modified opinion. (Ref: par. A24–A25)	A24. When the auditor expresses a qualified opinion, it would not be appropriate to use phrases such as "with the foregoing explanation" or "subject to" in the "Opinion" 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.

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<b>Requirements</b>	<b>Application and Other Explanatory Material</b>
	A25. 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.
Adverse Opinion	
19. When the auditor expresses an adverse opinion, the auditor should state that, in the auditor’s opinion, because of the significance of the matters described in the “Basis for Adverse Opinion” section, the accompanying financial statements do not present fairly [...] in accordance with [the applicable financial reporting framework].	
Disclaimer of Opinion	
20. When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor should do the following:	
a. State that the auditor does not express an opinion on the accompanying financial statements	
b. State that, because of the significance of the matters described in the “Basis for Disclaimer of Opinion” section, the auditor has not been able to obtain sufficient appropriate audit evidence	

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to provide a basis for an audit opinion on the financial statements	
c. Amend the statement required by paragraph <del>2325b</del> of <del>proposed</del> SAS <i>Forming an Opinion and Reporting on Financial Statements</i> , <u>or paragraph 60b of <i>Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA</i>, as applicable</u> , which indicates that the financial statements have been audited, to state that the auditor was engaged to audit the financial statements	
<b><i>Basis for Opinion</i></b>	<b><i>Basis for Opinion (Ref: par. 21, 22, 24, 28)</i></b>
21. When the auditor modifies the opinion on the financial statements, the auditor should, in addition to including the specific elements required by <del>proposed-SAS</del> <i>SAS Forming an Opinion and Reporting on Financial Statements</i> <u>or <i>Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans subject to ERISA</i></u> , do the following: (Ref: par. A26)	A26. Consistency in the auditor's report helps promote users' understanding and helps users 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.
a. Amend the heading "Basis for Opinion" required by paragraph <del>2628</del> of <del>proposed</del> SAS <i>Forming an Opinion and Reporting on Financial Statements</i> , <u>or paragraph xx of SAS <i>Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA</i>, as applicable</u> , to "Basis for Qualified Opinion," "Basis for Adverse Opinion," or "Basis for Disclaimer of Opinion," as appropriate	

*Modifications to the Opinion in the Independent Auditor's Report*  
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<b>Requirements</b>	<b>Application and Other Explanatory Material</b>
<p><i>b.</i> 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 “Basis for Opinion” 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 state that in this section. (Ref: par. A27)</p>	<p>A27. An example of the financial effects of misstatements that the auditor may describe within the “Basis for Opinion” 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 “Basis for Opinion” section may refer to the note.</p>
	<p>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” (AICPA, <i>Professional Standards</i>, 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.</p>
<p>23. If there is a material misstatement of the financial statements that relates to qualitative disclosures, the auditor should include an explanation of how the disclosures are misstated in the “Basis for Opinion” section.</p>	

*Modifications to the Opinion in the Independent Auditor's Report*  
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<b>Requirements</b>	<b>Application and Other Explanatory Material</b>
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 do the following:	
a. Discuss the omission of such information with those charged with governance	
b. Describe in the “Basis for Opinion” section the nature of the omitted information	
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)	A29. <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 and include it in the auditor’s report when management omits such information.
	A30. Disclosing the omitted information within the “Basis for Opinion” section would not be practicable if <ul style="list-style-type: none"> <li>• the information has not been prepared by management or the information is otherwise not readily available to the auditor or</li> <li>• in the auditor’s judgment, the information would be unduly voluminous in relation to the auditor’s report.</li> </ul>
25. If the modification results from an inability to obtain sufficient appropriate audit evidence, the auditor should include the reasons for that inability in the “Basis for Opinion” section. (Ref. Par. A31)	A31. 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.

*Modifications to the Opinion in the Independent Auditor's Report*  
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Requirements	Application and Other Explanatory Material
<p>26. When the auditor expresses a qualified or an adverse opinion, the auditor should amend the statement, required by paragraph <del>2628d</del> of <del>proposed</del> SAS <i>Forming an Opinion and Reporting on Financial Statements</i>, <u>or paragraph 68 of SAS <i>Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA</i>, as applicable</u>, about whether the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor's opinion, to include the word "qualified" or "adverse," as appropriate.</p>	
<p>27. When the auditor disclaims an opinion on the financial statements, the auditor's report should not include the elements required by paragraphs <del>2628b</del> and <del>2628d</del> of <del>proposed</del> SAS <i>Forming an Opinion and Reporting on Financial Statements</i> <u>or paragraphs xx and xx of SAS <i>Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA</i>, as applicable</u>. Those elements are</p>	
<p style="padding-left: 40px;">a. a reference to the section of the auditor's report where the auditor's responsibilities are described and</p>	
<p style="padding-left: 40px;">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 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, in the "Basis for Opinion" section. (Ref: par. A32–A33)</p>	<p>A32. An adverse opinion or a disclaimer of opinion relating to a specific matter described within the "Basis for Opinion" 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>

*Modifications to the Opinion in the Independent Auditor's Report*  
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Requirements	Application and Other Explanatory Material
	A33. The auditor may consider whether there is a need to describe in an emphasis-of-matter or other-matter paragraph <sup>6</sup> any other matters of which the auditor is aware that would not require a modification of the auditor's opinion.
<b>Description of Auditor's Responsibilities for the Audit of the Financial Statements When the Auditor Disclaims an Opinion on the Financial Statements</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>
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 <del>proposed</del> SAS <i>Forming an Opinion and Reporting on Financial Statements</i> or paragraphs xx-xx of SAS <i>Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA, as applicable</i> , to include only the following: (Ref: par. A34)	A34. 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 5–6 of the exhibit to this <del>proposed</del> SAS: <ul style="list-style-type: none"> <li>• The statement required by paragraph 2628a of <del>proposed</del> SAS <i>Forming an Opinion and Reporting on Financial Statements</i>, or <u>paragraph xx of SAS <i>Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA, as applicable</i></u>, 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 2628c of <del>proposed</del> SAS <i>Forming an Opinion and Reporting on Financial Statements</i>, or <u>paragraph xx of SAS <i>Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA, as applicable</i></u>, about independence and other ethical responsibilities.</li> </ul>

<sup>6</sup> See ~~proposed~~ SAS *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

*Modifications to the Opinion in the Independent Auditor's Report*  
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Requirements	Application and Other Explanatory Material
<p>a. 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>	
<p>b. A statement that, however, because of the matters described in the "Basis for Disclaimer of Opinion" section, the auditor was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements</p>	
<p>c. The statement <del>about that the</del> auditor <del>independence</del> <u>is required to be independent</u> and <u>to meet</u> other ethical responsibilities required by paragraph <del>2628c</del> of <del>proposed</del> <u>SAS Forming an Opinion and Reporting on Financial Statements, or paragraph xx of SAS Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA, as applicable</u></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>
<p>30. When the auditor expresses 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 <del>proposed</del> <u>SAS Communicating Key Audit Matters in the Independent Auditor's</u></p>	<p>A35. Describing the reasons for the modification of the opinion within the "Basis for Opinion" section of the auditor's report provides information to users that is useful in understanding why the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements. Furthermore, describing these reasons may guard against inappropriate reliance on the financial statements. However, providing further details about the audit may overshadow the reasons for the modification of the opinion and may potentially be confusing to users.</p>

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Requirements	Application and Other Explanatory Material
<p><i>Report.</i><sup>7</sup> Also, when the auditor disclaims an opinion on the financial statements, the auditor's report should not include an "Other Information" section in accordance with proposed SAS <i>The Auditor's Responsibilities Relating to Other Information Included in Annual Reports.</i><sup>8</sup> (Ref: par. A35–A36)</p>	
	<p>A36. When the auditor expresses an adverse opinion, the communication of any key audit matters other than the matters giving rise to the modified opinion may overshadow the fact that 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 matters 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. Similarly, it would not be appropriate for the auditor to make any statements about the auditor's consideration of the consistency of other information in an annual report with the financial statements. Accordingly, paragraph 30 of this <del>proposed</del> 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, and also prohibits the inclusion of an "Other Information" section in the auditor's report when the auditor disclaims an opinion on the financial statements.</p>
<p><b>Communication With Those Charged With Governance</b></p>	<p><b>Communication With Those Charged With Governance (Ref: par. 31)</b></p>

<sup>7</sup> Paragraphs 10–12 of ~~proposed~~ SAS *Communicating Key Audit Matters in the Independent Auditor's Report*.

<sup>8</sup> See footnote 2.

*Modifications to the Opinion in the Independent Auditor's Report*  
ASB Meeting, January 14-17, 2019

<b>Requirements</b>	<b>Application and Other Explanatory Material</b>
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. A37)	A37. Communicating with those charged with governance the circumstances that led to an expected modification to the auditor's opinion and the wording of the modification enables the following:
	<ul style="list-style-type: none"> <li>• The auditor to give notice to those charged with governance of the intended modification and the reasons (or circumstances) for the modification</li> </ul>
	<ul style="list-style-type: none"> <li>• The auditor to seek the concurrence of those charged with governance regarding the facts of the matters giving rise to the expected modification, or to confirm matters of disagreement with management as such</li> </ul>
	<ul style="list-style-type: none"> <li>• Those charged with governance to have an opportunity, when appropriate, to provide the auditor with further information and explanations regarding the matters giving rise to the expected modification</li> </ul>

**A38.**

**Exhibit—Illustrations of Auditor's Reports With Modifications to the Opinion**

Illustration 1: An Auditor's Report Containing a Qualified Opinion Due to a Material Misstatement of the Financial Statements

Illustration 2: An Auditor's Report Containing a Qualified Opinion for Inadequate Disclosure

Illustration 3: An Auditor's Report Containing an Adverse Opinion Due to a Material Misstatement of the Financial Statements

Illustration 4: An Auditor's Report Containing a Qualified Opinion Due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence

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

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

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

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

*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 the last sentence that was included in the extant Auditor's Responsibilities section are now subsumed as part of the new Basis for Opinion section.*

### **Illustration 1: An Auditor's Report Containing a Qualified Opinion Due to a Material Misstatement of the Financial Statements**

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in AU-C section 210.
- Inventories are misstated. The misstatement is deemed to be material but not pervasive to the financial statements. Accordingly, the auditor's report contains a qualified opinion.
- 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 period of time considered was one year after the date that the financial statements are issued which is consistent with management's going concern assessment required in accordance with GAAP.~~
- The auditor has obtained all of the other information prior to the date of the auditor's report and the matter giving rise to the qualified opinion on the financial statements also affects the other information included in the annual report.<sup>1</sup>
- The auditor has not been engaged to communicate key audit matters.

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<sup>1</sup> See footnote 2.

**Independent Auditor's Report**

[Appropriate Addressee]

[City and State]

**Report on the Audit of the Financial Statements<sup>2</sup>**

***Qualified Opinion***

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

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

***Basis for Qualified Opinion***

The Company has stated inventories at cost in the accompanying balance sheets. Accounting principles generally accepted in the United States of America require inventories to be stated at the lower of cost or market. If the Company stated inventories at the lower of cost or market, a write down of \$XXX and \$XXX would have been required as of December 31, 20X1 and 20X0, respectively. Accordingly, cost of sales would have been increased by \$XXX and \$XXX, and net income, income taxes, and stockholders' equity would have been reduced by \$XXX, \$XXX, and \$XXX, and \$XXX, \$XXX, and \$XXX, as of and for the years ended December 31, 20X1 and 20X0, respectively.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company, and ~~have fulfilled~~to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

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<sup>2</sup> The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

### ***Responsibilities of Management for the Financial Statements***

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

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern. ~~within one year after the date that the financial statements are issued.~~

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

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users made on the basis of these financial statements.

In performing an audit in accordance with GAAS, we:

- Use professional judgment and exercise professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>3</sup>

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<sup>3</sup> In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

- Evaluate 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 whether in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern ~~within one year after the date that the financial statements are issued~~ for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters identified during our audit.

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

*[Reporting in accordance with the reporting requirements in proposed SAS The Auditor's Responsibilities Relating to Other Information Included in Annual Reports—~~see illustration 3 in the appendix of that proposed SASS~~. The last paragraph of the other information section in illustration 3 of that proposed SAS would be customized to describe the specific matter giving rise to the qualified opinion that also affects the other information.]<sup>4</sup>*

**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~~ City and state where the auditor's report is issued]*

*[Date of the auditor's report]*

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<sup>4</sup> See footnote 2.

**Illustration 2: An Auditor's Report Containing a Qualified Opinion for Inadequate Disclosure**

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in AU-C section 210.
- The financial statements have inadequate disclosures. The auditor has concluded that (a) it is not practicable to present the required information and (b) the effects are such that an adverse opinion is not appropriate. Accordingly, the auditor's report contains a qualified opinion.
- 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 period of time considered was one year after the date that the financial statements are issued which is consistent with management's going concern assessment required in accordance with GAAP.~~
- The auditor has obtained all of the other information prior to the date of the auditor's report, and the matter giving rise to the qualified opinion on the financial statements also affects the other information included in the annual report.<sup>5</sup>
- The auditor has been engaged to communicate key audit matters.

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<sup>5</sup> See footnote 2.

**Independent Auditor's Report**

[Appropriate Addressee]

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

***Qualified Opinion***

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

In our opinion, except for the omission of the information described in the Basis for Qualified Opinion section of our report, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

***Basis for Qualified Opinion***

The Company's financial statements do not disclose [*describe the nature of the omitted information that is not practicable to present in the auditor's report*]. In our opinion, disclosure of this information is required by accounting principles generally accepted in the United States of America.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company, and ~~have fulfilled~~to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

***Key Audit Matters***

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

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<sup>6</sup> The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

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

### ***Responsibilities of Management for the Financial Statements***

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

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern, ~~within one year after the date that the financial statements are issued.~~

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

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users made on the basis of these financial statements.

In performing an audit in accordance with GAAS, we :

- Use professional judgment and exercise professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>7</sup>

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<sup>7</sup> In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

- Evaluate 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 whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern ~~within one year after the date that the financial statements are issued~~for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters identified during our audit.

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

*[Reporting in accordance with the reporting requirements in proposed SAS The Auditor's Responsibilities Relating to Other Information Included in Annual Reports—~~see illustration 3 in the appendix of that proposed SAS~~. The last paragraph of the Other Information section in illustration 3 of that proposed SAS would be customized to describe the specific matter giving rise to the qualified opinion that also affects the other information.]<sup>8</sup>*

**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~~City and state where the auditor's report is issued]*

*[Date of the auditor's report]*

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<sup>8</sup> See footnote 2.

### **Illustration 3: An Auditor's Report Containing an Adverse Opinion Due to a Material Misstatement of the Financial Statements**

Circumstances include the following:

- Audit of a complete set of consolidated general purpose financial statements (single year). The audit is a group audit. The auditor is not making reference to a component auditor in the auditor's report.
- Management is responsible for the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in AU-C section 210.
- The consolidated financial statements are materially misstated due to the nonconsolidation of a subsidiary. The material misstatement is deemed to be pervasive to the consolidated financial statements. Accordingly, the auditor's report contains an adverse opinion. The effects of the misstatement on the financial statements have not been determined because it was not practicable to do so.
- 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 period of time considered was one year after the date that the financial statements are issued which is consistent with management's going concern assessment required in accordance with GAAP.~~
- The auditor has obtained all of the other information prior to the date of the auditor's report and the matter giving rise to the adverse opinion on the consolidated financial statements also affects the other information included in the annual report.<sup>9</sup>
- The auditor is precluded from communicating key audit matters when issuing an adverse opinion.

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<sup>9</sup> See footnote 2.

**Independent Auditor's Report**

[Appropriate Addressee]

[City and State]

**Report on the Audit of the Consolidated Financial Statements<sup>10</sup>**

***Adverse Opinion***

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

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion section of our report, the accompanying consolidated financial statements do not present fairly the consolidated financial position of ABC Company and its subsidiaries as of December 31, 20X1, or the results of their operations or their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

***Basis for Adverse Opinion***

As described in Note X, the Company has not consolidated the financial statements of subsidiary XYZ Company that it acquired during 20X1 because it has not yet been able to ascertain the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This investment is therefore accounted for on a cost basis by the Company. Under accounting principles generally accepted in the United States of America, the subsidiary should have been consolidated because it is controlled by the Company. Had XYZ Company been consolidated, many elements in the accompanying consolidated financial statements would have been materially affected. The effects on the consolidated financial statements of the failure to consolidate have not been determined.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are required to be independent of ABC Company; and ~~have fulfilled~~to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse audit opinion.

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<sup>10</sup> The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

### ***Responsibilities of Management for the Consolidated Financial Statements***

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

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern. ~~within one year after the date that the financial statements are issued.~~

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

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users made on the basis of these consolidated financial statements.

In performing an audit in accordance with GAAS, we :

- Use professional judgment and exercise professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>11</sup>

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<sup>11</sup> In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern ~~within one year after the date that the financial statements are issued~~ for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters identified during our audit.

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

*[Reporting in accordance with the reporting requirements in proposed SAS The Auditor's Responsibilities Relating to Other Information Included in Annual Reports—~~see illustration 4 in the appendix of that proposed SAS~~. The last paragraph of the Other Information section in illustration 4 of that proposed SAS would be customized to describe the specific matter giving rise to the adverse opinion that also affects the other information.]<sup>12</sup>*

**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~~ City and state where the auditor's report is issued]*

*[Date of the auditor's report]*

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<sup>12</sup> See footnote 2.

**Illustration 4: An Auditor's Report Containing a Qualified Opinion Due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence**

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (single year). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in AU-C section 210.
- The auditor was unable to obtain sufficient appropriate audit evidence regarding an investment in a foreign affiliate. The possible effects of the inability to obtain sufficient appropriate audit evidence are deemed to be material but not pervasive to the financial statements. Accordingly, the auditor's report contains a qualified opinion.
- 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 in accordance with AU-C section 570. ~~The period of time considered was one year after the date that the financial statements are issued which is consistent with management's going concern assessment required in accordance with GAAP.~~
- The auditor has obtained all of the other information prior to the date of the auditor's report and the matter giving rise to the qualified opinion on the financial statements also affects the other information included in the annual report. <sup>13</sup>
- The auditor has not been engaged to communicate key audit matters.

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<sup>13</sup> See footnote 2.

**Independent Auditor's Report**

[Appropriate Addressee]  
[City and State]

**Report on the Audit of the Financial Statements<sup>14</sup>**

***Qualified 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, except for the possible effects of the matter described in the Basis for Qualified Opinion section of our report, 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 Qualified Opinion***

ABC Company's investment in XYZ Company, a foreign affiliate acquired during the year and accounted for under the equity method, is carried at \$XXX on the balance sheet at December 31, 20X1, and ABC Company's share of XYZ Company's net income of \$XXX is included in ABC Company's net income for the year then ended. We were unable to obtain sufficient appropriate audit evidence about the carrying amount of ABC Company's investment in XYZ Company as of December 31, 20X1, and ABC Company's share of XYZ Company's net income for the year then ended because we were denied access to the financial information, management, and the auditors of XYZ Company. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company, and ~~have fulfilled~~to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

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<sup>14</sup> The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

### ***Responsibilities of Management for the Financial Statements***

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

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern ~~within one year after the date that the financial statements are issued.~~

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

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users made on the basis of these financial statements.

In performing an audit in accordance with GAAS, we:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>15</sup>
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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<sup>15</sup> In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern ~~within one year after the date that the financial statements are issued.~~ for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters identified during our audit.

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

*[Reporting in accordance with the reporting requirements in proposed SAS The Auditor's Responsibilities Relating to Other Information Included in Annual Reports—~~see illustration 3 in the appendix of that proposed SAS.~~ The last paragraph of the Other Information section in illustration 3 of that proposed SAS would be customized to describe the specific matter giving rise to the qualified opinion that also affects the other information.]<sup>16</sup>*

**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~~ City and state where the auditor's report is issued]*

*[Date of the auditor's report]*

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<sup>16</sup> See footnote 2.

**Illustration 5: An Auditor's Report Containing a Disclaimer of Opinion Due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence About a Single Element of the Financial Statements**

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (single year). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in AU-C section 210.
- The auditor was unable to obtain sufficient appropriate audit evidence about a single element of the financial statements. That is, the auditor was unable to obtain audit evidence about the financial information of a joint venture investment accounted for under the proportionate consolidation approach. The investment represents over 90 percent of the Company's net assets. The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements. Accordingly, the auditor's report contains a disclaimer of opinion.
- The auditor concluded that it was unnecessary to include in the auditor's report specific amounts for the Company's proportional share of the assets, liabilities, income, and expenses of the joint venture investment because the investment represents over 90 percent of the Company's net assets, and that fact is disclosed in the auditor's report.
- The auditor is precluded from including an Other Information section in the auditor's report when disclaiming an opinion on the financial statements. [17](#)
- The auditor is precluded from communicating key audit matters when disclaiming an opinion on the financial statements.
- A more limited description of the Auditor's Responsibilities section is required because of the disclaimer of opinion.

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[17 See footnote 2.](#)

**Independent Auditor's Report**

[Appropriate Addressee]

[City and State]

**Report on the Audit of the Financial Statements<sup>18</sup>**

***Disclaimer of Opinion***

We were engaged to audit 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.

We do not express an opinion on the accompanying financial statements of ABC Company. Because of the significance of the matter described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

***Basis for Disclaimer of Opinion***

The Company's investment in XYZ Company, a joint venture, is carried at \$XXX on the Company's balance sheet, which represents over 90 percent of the Company's net assets as of December 31, 20X1. We were not allowed access to the management and the auditors of XYZ Company. As a result, we were unable to determine whether any adjustments were necessary relating to the Company's proportional share of XYZ Company's assets that it controls jointly, its proportional share of XYZ Company's liabilities for which it is jointly responsible, its proportional share of XYZ Company's income and expenses for the year, and the elements making up the statements of changes in stockholders' equity and cash flows.

***Responsibilities of Management for the Financial Statements***

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

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<sup>18</sup> The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern ~~within one year after the date that the financial statements are issued.~~

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

Our responsibility is to conduct an audit of ABC Company's financial statements in accordance with auditing standards generally accepted in the United States of America and to issue an auditor's report. However, because of the matter described in the Basis for Disclaimer of Opinion section of our report, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

We are required to be independent of ABC Company, and ~~have fulfilled to meet~~ our other ethical responsibilities, in accordance with the relevant ethical requirements relating to 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~~ City and state where the auditor's report is issued

*[Date of the auditor's report]*

**Illustration 6: An Auditor's Report Containing a Disclaimer of Opinion Due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence About Multiple Elements of the Financial Statements**

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (single year). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in AU-C section 210.
- The auditor was unable to obtain sufficient appropriate audit evidence about multiple elements of the financial statements. That is, the auditor was unable to obtain audit evidence about the entity's inventories and accounts receivable at year end because at that time the auditor had not been engaged. The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements. Accordingly, the auditor's opinion contains a disclaimer of opinion.
- The auditor is precluded from including an Other Information section in the auditor's report when disclaiming an opinion on the financial statements.<sup>19</sup>
- The auditor is precluded from communicating key audit matters when disclaiming an opinion on the financial statements.
- A more limited description of the Auditor's Responsibilities section is required because of the disclaimer of opinion.

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<sup>19</sup> See footnote 2.

**Independent Auditor's Report**

[Appropriate Addressee]

[City and State]

**Report on the Audit of the Financial Statements<sup>20</sup>**

***Disclaimer of Opinion***

We were engaged to audit 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.

We do not express an opinion on the accompanying financial statements of ABC Company. Because of the significance of the matters described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

***Basis for Disclaimer of Opinion***

We were not engaged as auditors of the Company until after December 31, 20X1, and, therefore, did not observe the counting of physical inventories at the beginning or end of the year. We were unable to satisfy ourselves by other auditing procedures concerning the inventory held at December 31, 20X1, which is stated in the balance sheet at \$XXX. In addition, the introduction of a new computerized accounts receivable system in September 20X1 resulted in numerous misstatements in accounts receivable. As of the date of our audit report, management was still in the process of rectifying the system deficiencies and correcting the misstatements. We were unable to confirm or verify by alternative means accounts receivable included in the balance sheet at a total amount of \$XXX at December 31, 20X1. As a result of these matters, we were unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded inventories and accounts receivable, and the elements making up the statements of income, changes in stockholders' equity, and cash flows.

***Responsibilities of Management for the Financial Statements***

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

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<sup>20</sup> The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern ~~within one year after the date that the financial statements are issued.~~

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

Our responsibility is to conduct an audit of ABC Company's financial statements in accordance with auditing standards generally accepted in the United States of America and to issue an auditor's report. However, because of the matters described in the Basis for Disclaimer of Opinion section of our report, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

We are required to be independent of ABC Company, and ~~have fulfilled~~to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to 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~~City and state where the auditor's report is issued

*[Date of the auditor's report]*

**Illustration 7: An Auditor's Report in Which the Auditor Is Expressing an Unmodified Opinion in the Prior Year and a Modified Opinion (Qualified Opinion) in the Current Year**

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in AU-C section 210.
- Certain lease obligations have been excluded from the financial statements in the current year. The effect of the exclusion is material but not pervasive. The auditor expressed an unmodified opinion in the prior year and is expressing a modified opinion (qualified opinion) in the current year.
- 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 period of time considered was one year after the date that the financial statements are issued which is consistent with management's going concern assessment required in accordance with GAAP.570.~~
- The auditor has not been engaged to communicate key audit matters.

**Independent Auditor's Report**

[Appropriate Addressee]

[City and State]

**Report on the Audit of the Financial Statements<sup>21</sup>**

***Qualified Opinion***

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

In our opinion, except for the effects on the accompanying 20X1 financial statements of not capitalizing certain lease obligations as described in the Basis for Qualified Opinion section of our report, the financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1 and 20X0, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

***Basis for Qualified Opinion on the 20X1 Financial Statements***

The Company has excluded, from property and debt in the accompanying 20X1 balance sheet, certain lease obligations that were entered into in 20X1 which, in our opinion, should be capitalized in accordance with accounting principles generally accepted in the United States of America. If these lease obligations were capitalized, property would be increased by \$XXX, long-term debt by \$XXX, and retained earnings by \$XXX as of December 31, 20X1, and net income and earnings per share would be increased (decreased) by \$XXX and \$XXX, respectively, for the year then ended.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company; and ~~have fulfilled to meet~~ our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion on the 20X1 financial statements and for our opinion on the 20X0 financial statements.

***Responsibilities of Management for the Financial Statements***

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<sup>21</sup> The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

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

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern ~~within one year after the date that the financial statements are issued.~~

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

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users made on the basis of these financial statements.

In performing an audit in accordance with GAAS, we:

- Use professional judgment and exercise professional skepticism throughout the audit.
- Identify and assess, the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>22</sup>
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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<sup>22</sup> In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern ~~within one year after the date that the financial statements are issued~~ for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters 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 auditor's firm]*

~~Auditor's city~~ City and state where the auditor's report is issued

*[Date of the auditor's report]*

**Illustration 8: An Auditor's Report in Which the Auditor Is Expressing an Unmodified Opinion in the Current Year and a Disclaimer of Opinion on the Prior-Year Statements of Income, Changes in Stockholders' Equity, and Cash Flows**

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). The audit is not a group audit.
- Management is responsible for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in AU-C section 210.
- The auditor was unable to observe the physical inventory as of December 31, 20X0, because at that time the auditor had not been engaged. Accordingly, the auditor was unable to obtain sufficient appropriate audit evidence regarding the net income and cash flows for the year ended December 31, 20X1. The effects of the inability to obtain sufficient appropriate audit evidence are deemed material and pervasive.
- In accordance with paragraph A26 of ~~proposed~~ SAS *Forming an Opinion and Reporting on Financial Statements*, the opinion does not separately refer to the statement of changes in stockholders' equity because changes in stockholders' equity accounts are considered part of the presentation of financial position, results of operations, and cash flows.
- The auditor expressed an unmodified opinion on the December 31, 20X2 and 20X1, balance sheets and a disclaimer of opinion on the 20X1 statements of income, changes in stockholders' equity, and cash flows.
- 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 period of time considered was one year after the date that the financial statements are issued which is consistent with management's going concern assessment required in accordance with GAAP.~~
- The auditor has not been engaged to communicate key audit matters.

**Independent Auditor's Report**

[Appropriate Addressee]

[City and State]

**Report on the Audit of the Financial Statements<sup>23</sup>**

***Opinion***

We have audited the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X2 and 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying balance sheets of ABC Company as of December 31, 20X2 and 20X1, and the statements of income, changes in stockholders' equity, and cash flows for the year ended December 31, 20X2, present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X2 and 20X1, and the results of its operations and its cash flows for the year ended December 31, 20X2, in accordance with accounting principles generally accepted in the United States of America.

***Disclaimer of Opinion on 20X1 Operations and Cash Flows***

We do not express an opinion on the accompanying results of operations and cash flows for the year ended December 31, 20X1. Because of the significance of the matter described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the results of operations and cash flows.

***Basis for Opinion***

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company; and ~~have fulfilled to meet~~ our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions on the balance sheets as of December 31, 20X2 and 20X1, and the statements of income, changes in stockholders' equity, and cash flows for the year ended December 31, 20X2.

***Basis for Disclaimer of Opinion on 20X1 Operations and Cash Flows***

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<sup>23</sup> The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

We did not observe the taking of the physical inventory as of December 31, 20X0, because that date was prior to our engagement as auditors for the Company, and we were unable to satisfy ourselves regarding inventory quantities by means of other auditing procedures. Inventory amounts as of December 31, 20X0, enter into the determination of net income and cash flows for the year ended December 31, 20X1.

***Responsibilities of Management for the Financial Statements***

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

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern ~~within one year after the date that the financial statements are issued.~~

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

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users made on the basis of these financial statements.

In performing an audit in accordance with GAAS, we:

- Use professional judgment and exercise professional skepticism throughout the audit
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>24</sup>
- Evaluate 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 whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern ~~within one year after the date that the financial statements are issued~~ for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters 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~~ City and state where the auditor's report is issued]*

*[Date of the auditor's report]*

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<sup>24</sup> In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

