



Agenda Item 1D (Marked)

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

~~PROPOSED~~ STATEMENT ON AUDITING STANDARDS EMPHASIS-OF-MATTER PARAGRAPHS AND OTHER-MATTER PARAGRAPHS IN THE INDEPENDENT AUDITOR'S REPORT

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Proposed Statement on Auditing Standards *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*

Requirements	Application Material
Introduction	
Scope of This Proposed Statement on Auditing Standards	Scope of This Proposed Statement on Auditing Standards (Ref: par. 4)
1. This proposed Statement on Auditing Standards (SAS) addresses additional communications in the auditor's report when the auditor considers it necessary to	
<ul style="list-style-type: none"> a. draw users' attention to a matters presented or disclosed in the financial statements that are of such importance that they are fundamental to users' understanding of the financial statements (emphasis-of-matter paragraph); or 	
<ul style="list-style-type: none"> b. draw users' attention to any matters other than those presented or disclosed in the financial statements that are relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report (other-matter paragraph). 	

	<i>The Relationship Between Emphasis-of-Matter Paragraphs and Key Audit Matters in the Auditor's Report (Ref: par. 2, 8b)</i>
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2. The communication of key audit matters is not required by ~~proposed~~ SAS *Forming an Opinion and Reporting on Financial Statements*, [SAS Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA](#), or ~~proposed~~ SAS *Communicating Key Audit Matters in the Independent Auditor's Report*. However, when the auditor is engaged to communicate key audit matters, this ~~proposed~~ SAS addresses the relationship between key audit matters and any additional communication in the auditor's report in accordance with this ~~proposed~~ SAS. (Ref: par. A1)

A1. *Key audit matters* are defined in ~~proposed~~ SAS *Communicating Key Audit Matters in the Independent Auditor's Report* as those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance, which include significant findings from the audit of the

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	<p>financial statements of the current period.^{1,*} Communicating key audit matters provides additional information to intended users of the financial statements to assist them in understanding those matters that, in the auditor's professional judgment, were of most significance in the audit and may also assist them in understanding the entity and areas of significant management judgment in the audited financial statements. When proposed—SAS <i>Communicating Key Audit Matters in the Independent Auditor's Report</i> applies, the use of emphasis-of-matter paragraphs is not a substitute for a description of individual key audit matters.</p>
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<p>3. AU-C section 570, <i>The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern</i>, and proposed SAS <i>The Auditor's Responsibilities Relating to Other Information Included in Annual Reports</i>¹ address communication in the auditor's report relating to going concern and other information, respectively. (Ref. par. A2)</p>	<p>A2. If, after considering identified conditions or events and management's plans, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains, the auditor is required to include a separate section in the auditor's report under the heading "Substantial Doubt About the Entity's Ability to Continue as a Going Concern."² If conditions or events, considered in the aggregate, have been identified that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time but, based on the audit evidence obtained, the</p>
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¹ Paragraph 14 of ~~proposed amendment to~~ AU-C section 260, *Communication With Those Charged with Governance*.

* All AU-C sections can be found in AICPA *Professional Standards*.

¹ Note: References to proposed SAS, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports* have been shown in shaded text. This text is included for reference purposes but is subject to further change as a result of the finalization of proposed SAS, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*. The shaded text will be removed from the final approved standard and conforming amendments to the suite of Auditor Reporting Standards will be made when that standard is finalized.

² Paragraph .24 of AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.

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	<p>auditor concludes that substantial doubt has been alleviated by management's plans and adequate disclosure has been made in the financial statements, the auditor may include an emphasis-of-matter paragraph in accordance with this proposed-SAS, making reference to management's disclosures related to the conditions and events and management's plans related to those conditions and events.³</p>
<p>4. Exhibit B, "List of AU-C Sections Containing Requirements for Emphasis-of-Matter Paragraphs," and exhibit C, "List of AU-C Sections Containing Requirements for Other-Matter Paragraphs," identify AU-C sections containing specific requirements for the auditor to include an emphasis-of-matter paragraph or other-matter paragraph, respectively, in the auditor's report. When an emphasis-of-matter or other-matter paragraph is required, the requirements in this proposed SAS regarding the form of such paragraphs apply. (Ref: par. A3)</p>	<p>A3. The AU-C sections identified in exhibits B and C require the auditor to include an emphasis-of-matter paragraph or other-matter paragraph, respectively, in the auditor's report relating to certain matters. The nature of these matters is such that they are brought to the attention of users of the auditor's report in all instances rather than at the discretion of the auditor. The explanatory language provided by such required paragraphs achieves the same objective as an emphasis-of-matter or other-matter paragraph that is included based on the professional judgment of the auditor (that is, to provide additional communication to the users of the auditor's report). Therefore, the auditor follows the requirements in this section regarding the form of these required paragraphs.</p>
<p>Effective Date</p>	
<p>5. This proposed-SAS will be<u>is</u> effective for audits of financial statements for periods ending on or after June<u>December</u> 15, 2019.[†]<u>2020</u>. Early implementation is not permitted.</p>	

³ Paragraphs .A54-.A56 of AU-C section 570.

[†] ~~This effective date is provisional but will not be earlier than June 15, 2019.~~

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Objective	
6. The objective of the auditor, having formed an opinion on the financial statements, is to draw users' attention, when in the auditor's judgment it is necessary to do so, by way of clear additional communication in the auditor's report, to the following:	
<i>a.</i> A matter, although appropriately presented or disclosed in the financial statements, that is of such importance that it is fundamental to users' understanding of the financial statements	
<i>b.</i> As appropriate, any other matter that is relevant to users' understanding of the audit, the auditor's responsibilities, or the auditor's report	
Definitions	
7. For purposes of generally accepted auditing standards (GAAS), the following terms have the meanings attributed as follows:	
Emphasis-of-matter paragraph. A paragraph included in the auditor's report that is required by GAAS, or is included at the auditor's discretion, and that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's professional judgment, is of such importance that it is fundamental to users' understanding of the financial statements.	

Other-matter paragraph. A paragraph included in the auditor's report that is required by GAAS, or is included at the auditor's discretion, and that refers to a matter other than those presented or disclosed in the	
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financial statements that, in the auditor's professional judgment, is relevant to users' understanding of the audit, the auditor's responsibilities, or the auditor's report.	
Requirements	
Emphasis-of-Matter Paragraphs in the Auditor's Report	Emphasis-of-Matter Paragraphs in the Auditor's Report
8. If the auditor considers it necessary to draw users' attention to a matter appropriately presented or disclosed in the financial statements that, in the auditor's professional judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor should include an emphasis-of-matter paragraph in the auditor's report, provided that the following apply: (Ref: par. A4–A5)	<i>Circumstances in Which an Emphasis-of-Matter Paragraph May Be Necessary (Ref: par. 8)</i>

	A4. In addition to the required emphasis-of-matter paragraphs listed in exhibit B, the following are examples of circumstances in which the auditor may consider it necessary to include an emphasis-of-matter paragraph:
	<ul style="list-style-type: none"> • An uncertainty relating to the future outcome of unusually important litigation or regulatory action
	<ul style="list-style-type: none"> • A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report⁴
	<ul style="list-style-type: none"> • A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position or results of operations

⁴ Paragraph .7 of AU-C section 560, *Subsequent Events and Subsequently Discovered Facts*.

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	<ul style="list-style-type: none"> • Significant transactions with related parties
	<p>A5. Paragraph 8 requires that an emphasis-of-matter paragraph refer only to matters appropriately presented or disclosed in the financial statements. To include information in an emphasis-of-matter paragraph about a matter beyond what is presented or disclosed in the financial statements may raise questions about the appropriateness of such presentation or disclosure.</p>
<p>a. The auditor would not be required to modify the opinion in accordance with proposed SAS <i>Modifications to the Opinion in the Independent Auditor's Report</i> as a result of the matter.</p>	
<p>b. When proposed SAS <i>Communicating Key Audit Matters in the Independent Auditor's Report</i> applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report. (Ref: par. A1)</p>	
<p>9. When the auditor includes an emphasis-of-matter paragraph in the auditor's report, the auditor should do the following:</p>	
<p>a. Include the paragraph within a separate section of the auditor's report with an appropriate heading. ²²When key audit matters are communicated in the auditor's report, the heading should include the term "Emphasis of Matter." (Ref. par. A6)</p>	<p>A6. The term "Emphasis of Matter" is required to be included in the heading when key audit matters are communicated to clearly differentiate that matter from those included in the Key Audit Matters section of the auditor's report. The auditor may add further context to the heading "Emphasis of Matter" (for example, "Emphasis of Matter—Subsequent Event") to further describe the nature of the matter addressed by the emphasis-of-matter paragraph.</p>

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<p>b. Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements. The paragraph should refer only to information presented or disclosed in the financial statements.</p>	
	<p><i>Including an Emphasis of Matter Paragraph in the Auditor's Report</i> (Ref: par. 9)</p>
<p>c. Indicate that the auditor's opinion is not modified with respect to the matter emphasized. (Ref: par. A7–A8, A14–A15)</p>	<p>A7. The inclusion of an emphasis-of-matter paragraph in the auditor's report does not affect the auditor's opinion. An emphasis-of-matter paragraph is not a substitute for the following:</p> <ul style="list-style-type: none"> • A modified opinion in accordance with proposed SAS <i>Modifications to the Independent Auditor's Report</i>, when required by the circumstances of a specific audit engagement
	<ul style="list-style-type: none"> • Disclosures in the financial statements that the applicable financial reporting framework requires management to make or that are otherwise necessary to achieve fair presentation
	<ul style="list-style-type: none"> • Reporting in accordance with proposed amendment to AU-C section 570 when, after considering identified conditions or events and management's plans, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains, in which case the auditor is required to include a separate section in the auditor's report (see paragraph A2)
	<p>A8. Paragraphs A14–A15 provide further guidance on the placement</p>

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	of emphasis-of-matter paragraphs in particular circumstances.
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Other-Matter Paragraphs in the Auditor's Report	Other-Matter Paragraphs in the Auditor's Report (Ref: par. 10–11)
	<i>Circumstances in Which an Other-Matter Paragraph May Be Necessary</i>
	<i>Relevant to Users' Understanding of the Audit</i>
10. If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's professional judgment, is relevant to users' understanding of the audit, the auditor's responsibilities, or the auditor's report, the auditor should include an other-matter paragraph in the auditor's report, provided that when proposed SAS <i>Communicating Key Audit Matters in the Independent Auditor's Report</i> applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report. (Ref: par. A9–A12)	A9. When the auditor is unable to withdraw from an engagement, even though the possible effect of an inability to obtain sufficient appropriate audit evidence due to a limitation on the scope of the audit imposed by management is pervasive, ⁵ the auditor may consider it necessary to include an other-matter paragraph in the auditor's report to explain why it is not possible for the auditor to withdraw from the engagement.
	<i>Relevant to Users' Understanding of the Auditor's Responsibilities or the Auditor's Report</i>

	A10. Law, regulation, or generally accepted practice may require or permit the auditor to elaborate on matters that provide further explanation of the auditor's responsibilities in the audit of the financial statements or of the auditor's report thereon. When the "Other Matter" section includes
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⁵ See paragraph 13 of ~~proposed~~ SAS *Modifications to the Independent Auditor's Report* for a discussion of this circumstance.

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	<p>more than one matter that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities, or the auditor's report, it may be helpful to use different subheadings for each matter.</p>
	<p>A11. An other-matter paragraph does not address circumstances in which the auditor has other reporting responsibilities that are in addition to the auditor's responsibility under GAAS (see the section "Other Reporting Responsibilities" in proposed <i>SAS Forming an Opinion and Reporting on Financial Statements</i> <u>or SAS Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA</u>), or when the auditor has been asked to perform and report on additional specified procedures, or to express an opinion on specific matters.</p>

	<p style="text-align: center;"><i>Reporting on More Than One Set of Financial Statements</i></p>
	<p>A12. An entity may prepare one set of financial statements in accordance with a general purpose framework (for example, accounting principles generally accepted in the United States of America) and another set of financial statements in accordance with another general purpose framework (for example, International Financial Reporting Standards promulgated by the International Accounting Standards Board) and engage the auditor to report on both sets of financial statements. If the auditor has determined that the frameworks are acceptable in the respective circumstances, the auditor may include an other-matter paragraph in the auditor's report, referring to the fact that another set of financial statements has been prepared by the same entity in accordance with another general purpose framework and that the auditor has issued a report on those financial statements.</p>

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	<i>Including an Other-Matter Paragraph in the Auditor's Report</i>
11. When the auditor includes an other-matter paragraph in the auditor's report, the auditor should include the paragraph within a separate section with the heading "Other Matter" or other appropriate heading. (Ref: par. A13–A15)	A13. The content of an other-matter paragraph clearly reflects that such other matter is not required to be presented and disclosed in the financial statements. An other-matter paragraph does not include information that the auditor is prohibited from providing by law, regulation, or other professional standards (for example, ethical standards relating to confidentiality of information.) An other-matter paragraph also does not include information that is required to be provided by management.

	Placement of Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Auditor's Report (Ref: par. 9, 11)
	A14. The placement of an emphasis-of-matter paragraph or other-matter paragraph in the auditor's report depends on the nature of the information to be communicated and the auditor's judgment about the relative significance of such information to intended users compared to other elements required to be reported in accordance with proposed -SAS <i>Forming an Opinion and Reporting on Financial Statements</i> , <u>or SAS <i>Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA</i></u> . For example:
	<ul style="list-style-type: none"> • <i>Emphasis-of-Matter Paragraphs</i>. When a "Key Audit Matters" section is presented in the auditor's report, an emphasis-of-matter paragraph may be presented either directly before or after the "Key Audit Matters" section, based on the auditor's judgment about the relative significance of the information included in the emphasis-of-matter paragraph. The auditor may also add further context to the heading "Emphasis of Matter," such as "Emphasis

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	<p>of Matter—Subsequent Event,” to differentiate the emphasis-of-matter paragraph from the individual matters described in the “Key Audit Matters” section.</p>
	<ul style="list-style-type: none"> • <i>Other-Matter Paragraphs:</i> <ul style="list-style-type: none"> — When a “Key Audit Matters” section is presented in the auditor’s report and an other-matter paragraph is also considered necessary, the auditor may add further context to the heading “Other Matter,” such as “Other Matter—Scope of the Audit,” to differentiate the other-matter paragraph from the individual matters described in the “Key Audit Matters” section.
	<ul style="list-style-type: none"> — When an other-matter paragraph is included to draw users’ attention to a matter relating to other reporting responsibilities addressed in the auditor’s report, the paragraph may be included in the section “Report on Other Legal and Regulatory Requirements.”
	<ul style="list-style-type: none"> — When relevant to all the auditor’s responsibilities or to users’ understanding of the auditor’s report, the other-matter paragraph may be included as a separate section following the sections “Report on the Audit of the Financial Statements” and “Report on Other Legal and Regulatory Requirements.”
	<p>A15. Exhibit D is an illustration of the interaction between the “Key Audit Matters” section, an emphasis-of-matter paragraph, and an other-matter paragraph when all are presented in the auditor’s report.</p>

	Illustration 2 in exhibit A includes an emphasis-of-matter paragraph in an auditor's report that contains a qualified opinion and for which key audit matters have not been communicated.
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Communication With Those Charged With Governance	Communication With Those Charged with Governance (Ref. par. 12)
12. If the auditor expects to include an emphasis-of-matter or other-matter paragraph in the auditor's report, the auditor should communicate with those charged with governance regarding this expectation and the wording of the paragraph. (Ref: par. A16)	A16. The auditor's communication with those charged with governance required by paragraph 12 enables those charged with governance to be made aware of the nature of any specific matters that the auditor intends to highlight in the auditor's report and provides them with an opportunity to obtain further clarification from the auditor when necessary. As discussed in paragraph .A50 of AU-C section 260, certain matters may be more important to communicate prior to the issuance of the auditor's report. When the inclusion of an other-matter paragraph on a particular matter in the auditor's report recurs on each successive engagement, the auditor may determine that it is unnecessary to repeat the communication on each engagement.

A17.

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

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

Illustration 2: Illustration of an Auditor's Report That Includes a Key Audit Matters Section, an Emphasis-of-Matter Paragraph, and an Other-Matter Paragraph

Illustration 3: An Auditor's Report With an Other-Matter Paragraph That May Be Appropriate When an Auditor Issues an Updated Report on the Financial Statements of a Prior Period That Contains an Opinion Different From the Opinion Previously Expressed

Illustration 4: An Auditor's Report With a Qualified Opinion Due to a Material Misstatement of the Financial Statements and an Emphasis-of-Matter Paragraph Because There Is Uncertainty Relating to a Pending Unusually Important Litigation Matter

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

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

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (single year). The audit is not a group audit.
- 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 has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.
- There is uncertainty relating to a pending unusually important litigation matter.
- The auditor's report includes an emphasis-of-matter paragraph.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with AU-C section 570. ~~The 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 Statements¹

Opinion

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

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

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be 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 that we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter

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

Responsibilities of Management for the Financial Statements

¹ The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

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 the ABC Company's internal control. Accordingly, no such opinion is expressed.²

² In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the 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 the 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]

Illustration 2: An Auditor's Report That Includes a Key Audit Matters Section, an Emphasis-of-Matter Paragraph, and an Other-Matter Paragraph

Circumstances include the following:

- Audit of a complete set of general purpose financial statements. The audit is not a group audit.
- 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 has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.
- Between the date of the financial statements and the date of the auditor's report, there was a fire in the entity's production facilities, which was disclosed by the entity as a subsequent event. In the auditor's judgment, the matter is of such importance that it is fundamental to users' understanding of the financial statements. The matter did not require significant auditor attention in the audit of the financial statements in the current period.
- The prior period financial statements were audited by a predecessor auditor.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with AU-C section 570. ~~The 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 has not identified a material misstatement of the other information included in the annual report.³
- The auditor has been engaged to communicate key audit matters.

³ See footnote 2.

Independent Auditor's Report

[Appropriate Addressee]
[City and State]

Report on the Audit of the Financial Statements⁴

Opinion

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

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

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be 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 opinion.

Emphasis of Matter⁵

As discussed in Note X to the financial statements, subsequent to the date of the financial statements, there was a fire in the Company's production facilities. Our opinion is not modified with respect to this matter.

Key Audit Matters

⁴ 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.

⁵ As noted in paragraph A14, an emphasis-of-matter paragraph may be presented either directly before or after the "Key Audit Matters" section, based on the auditor's judgment about the relative significance of the information included in the emphasis-of-matter paragraph.

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

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

Other Matter

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

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 ~~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 ~~evidence~~ regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.⁶
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as the 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 [for another title if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[Reporting in accordance with the reporting requirements in proposed SAS The Auditor's Responsibilities Relating to Other Information Included in Annual Reports—see illustration 1 in the appendix of that proposed SAS.]⁷

Report on Other Legal and Regulatory Requirements

⁶ In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

⁷ [See footnote 2.](#)

[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 3: An Auditor's Report With an Other-Matter Paragraph That May Be Appropriate When an Auditor Issues an Updated Report on the Financial Statements of a Prior Period That Contains an Opinion Different From the Opinion Previously Expressed

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). The audit is not a group audit.
- 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's report on the prior period financial statements expressed an adverse opinion due to identified departures from accounting principles generally accepted in the United States of America that resulted in the financial statements being materially misstated. The entity has elected to change its method of accounting for the matters that gave rise to the adverse opinion in the prior period and has restated the prior period financial statements. Therefore, the auditor has expressed an unmodified opinion on the comparative financial statements.
- The auditor's report includes an other-matter paragraph indicating that the updated report on the financial statements of the prior period contains an opinion different from the opinion previously expressed, as required by ~~proposed~~ SAS *Forming an Opinion and Reporting on Financial Statements*.
- Although the entity changed its method of accounting for the matters that gave rise to the adverse opinion in the prior period and corrected the material misstatement in the 20X0 financial statements, the principal objective of the communication in the other-matter paragraph is to draw users' attention to the change in the auditor's opinion on the prior period financial statements. The other-matter paragraph refers to the change in accounting principle and the related disclosure in the financial statements. Therefore, the other-matter paragraph also meets the objective of communicating the change in accounting principle as required by AU-C section 708, *Consistency of Financial Statements*, and a separate emphasis-of-matter paragraph is not considered necessary.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going

concern for a reasonable period of time in accordance with AU-C section 570. ~~The 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 Statements¹

Opinion

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

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

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be 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 that we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Other Matter

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

¹ The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements" is not applicable.

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

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.²
- 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]

² In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

Illustration 4: An Auditor's Report With a Qualified Opinion Due to a Material Misstatement of the Financial Statements and an Emphasis-of-Matter Paragraph Because There Is Uncertainty Relating to a Pending Unusually Important Litigation Matter

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.
- Inventories are misstated. The misstatement is deemed to be material but not pervasive to the financial statements.
- There is uncertainty relating to a pending unusually important litigation matter.
- The auditor's report includes a qualified opinion and also includes an emphasis-of-matter paragraph.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with AU-C section 570. ~~The 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 Statements¹

Qualified Opinion

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

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, 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

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

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (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.

Emphasis of Matter—Litigation

¹ The subtitle "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

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

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~~ [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.²
- 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]

² In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the 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."

A18.

Exhibit B—List of AU-C Sections Containing Requirements for Emphasis-of-Matter Paragraphs

(Ref. par. 4)

This exhibit identifies paragraphs in other AU-C sections in AICPA *Professional Standards* that require the auditor to include an emphasis-of-matter paragraph in the auditor's report in certain circumstances. The list is not a substitute for considering the requirements and related application and other explanatory material in specific AU-C sections.

- Paragraph .16c of section 560, *Subsequent Events and Subsequently Discovered Facts*
- Paragraphs .08–.09 and .11–.13 of section 708, *Consistency of Financial Statements*
- Paragraphs .19 and .21 of section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*

A19.

Exhibit C—List of AU-C Sections Containing Requirements for Other-Matter Paragraphs

(Ref. par. 4)

This exhibit identifies paragraphs in other AU-C sections in AICPA *Professional Standards* that require the auditor to include an other-matter paragraph in the auditor's report in certain circumstances. The list is not a substitute for considering the requirements and related application and other explanatory material in specific AU-C sections.

- Paragraph .16c of section 560, *Subsequent Events and Subsequently Discovered Facts*
- [Paragraphs 56-57 and 59-60 of SAS Forming an Opinion and Reporting on Financial Statements](#)
- [Paragraphs 50, 87-88, 90-91, 114, and 126 of SAS Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA](#)
- Paragraph .09 of section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*
- Paragraph .07 of section 730, *Required Supplementary Information*
- Paragraph .20 of section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*
- Paragraph .13 of section 806, *Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements*
- Paragraph .07 of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*

~~Paragraphs 55–56 and 58–59 of proposed SAS Forming an Opinion and Reporting on Financial Statements also include requirements for other-matter paragraphs.~~

