



Agenda Item 1F

Auditor Reporting

STATEMENTS ON AUDITING STANDARDS—AUDITOR REPORTING

[Forming an Opinion and Reporting on Financial Statements](#)

[Communicating Key Audit Matters in the Independent Auditor's Report](#)

[Modifications to the Opinion in the Independent Auditor's Report](#)

[Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report](#)

AUDITOR REPORTING

New AU-C section 701; **Supersedes** AU-C section 700, *Forming an Opinion and Reporting on Financial Statements*; AU-C section 705, *Modifications to the Opinion in the Independent Auditor's Report*; and AU-C section 706, *Modifications to the Opinion in the Independent Auditor's Report*.

Amends AU-C sections [210](#), *Terms of Engagement*; [220](#), *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*; [230](#), *Audit Documentation*; [260](#), *The Auditor's Communication With Those Charged With Governance*; [510](#), *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements*; [540](#), *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*; [600](#), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

Amends SAS No. 132, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* (AICPA, Professional Standards, AU-C sec. 570)

PROPOSED AMENDMENTS—ADDRESSING DISCLOSURES IN THE AUDIT OF FINANCIAL STATEMENTS

Amends AU-C sections [200](#), *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*; [210](#), *Terms of Engagement*; [240](#), *Consideration of Fraud in a Financial Statement Audit*; [260](#), *The Auditor's Communication With Those Charged With Governance*; [300](#), *Planning an Audit*; [315](#), *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*; [320](#), *Materiality in Planning and Performing an Audit*; [330](#), *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*; [450](#), *Evaluation of Misstatements Identified During the Audit*; [540](#), *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*; [800](#), *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*; and [805](#), *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*

Appendix—Amendments to Various Sections in SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*, as Amended, and SAS No. 132, *The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern*

Amendments to Various Sections in SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*, as Amended

(Boldface italics denote new language. Deleted text is in ~~strikethrough~~.)

The amendment to each AU-C section is effective for audits of financial statements for periods ending on or after December 15, 2020. ~~June 15, 2019.~~ * Early implementation is not permitted.

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

AU-C Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with GAAS*[†]

[†]All AU-C sections can be found in AICPA Professional Standards.

[No amendments to paragraphs .01–.14.]

Definitions

.14 For purposes of GAAS, the following terms have the meanings attributed as follows:

...

Financial statements. A structured representation of historical financial information, including ~~related notes~~ *disclosures*, intended to communicate an entity’s economic resources or obligations at a point in time, or the changes therein for a period of time, in accordance with a financial reporting framework. ~~The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information.~~ The term *financial statements* ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework, but can also refer to a single financial statement. *Disclosures comprise explanatory or descriptive information, set out as required, expressly permitted or otherwise allowed by the applicable financial reporting framework, on the face of a financial statement or in the notes, or incorporated therein by reference.*

[No further amendments to AU-C section 200.]

AU-C Section 210, *Terms of Engagement*

[No amendments to paragraphs .01–.09.]

Agreement on Audit Engagement Terms

.10 The agreed-upon terms of the audit engagement should be documented in an audit engagement letter or other suitable form of written agreement and should include the following: (Ref: par. .A22–.A26)

- a. The objective and scope of the audit of the financial statements
- b. The responsibilities of the auditor
- c. The responsibilities of management
- d. A statement that because of the inherent limitations of an audit, together with the inherent limitations of internal control, an unavoidable risk exists that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with GAAS
- e. Identification of the applicable financial reporting framework for the preparation of the financial statements
- f. Reference to the expected form and content of any reports to be issued by the auditor and a statement that circumstances may arise in which a report may differ from its expected form and content (*Ref. par. .A24*)

[No amendments to paragraphs .11–.A1.]

Preconditions for an Audit

[No amendments to paragraphs .A2–.A8.]

Agreement of the Responsibilities of Management (Ref: par. .06b)

.A9 An audit in accordance with GAAS is conducted on the premise that management has acknowledged and understands that it has the responsibilities set out in paragraph 6b.⁵ The auditor may assist in preparing the financial statements, in whole or in part, based on information provided to the auditor by management during the performance of the audit.* However, the concept of an independent audit requires that the auditor’s role does not involve assuming management’s responsibility for the preparation and fair presentation of the financial statements or assuming responsibility for the entity’s related internal control and that the auditor has a reasonable expectation of obtaining the information necessary for the audit (*including information obtained from outside of the general and subsidiary ledgers*) in so far as management is able to provide or procure it. Accordingly, the premise is fundamental to the conduct of an independent audit. To avoid misunderstanding, agreement is reached with management that it acknowledges and understands that it has such responsibilities as part of agreeing and documenting the terms of the audit engagement in paragraphs .09–.10.

⁵ [Footnote omitted for the purposes of this ~~proposed~~-SAS.]

*[Footnote omitted for the purposes of this ~~proposed~~-SAS.]

[No amendments to paragraphs .A10–.A16.]

Additional Information (Ref. par. .06biii(2))

.A17 Additional information that the auditor may request from management for the purpose of the audit may include, when applicable, matters related to other information in accordance with proposed SAS The Auditor’s Responsibilities Relating to Other Information Included in Annual Reports. When the auditor expects to obtain other information after the date of the auditor’s report, the terms of the audit engagement may also acknowledge the auditor’s responsibilities relating to such other information including, if applicable, the actions that may be appropriate or necessary if the auditor concludes that a material misstatement of the other information exists in such other information.¹

[Paragraphs .A17–.A22 are renumbered as paragraphs .A18–A23. The content is unchanged.]

Audit Engagement Letter or Other Form of Written Agreement¹⁰ (Ref. par. .10)

Form and Content of the Audit Engagement Letter

~~.A23~~ **A24** The form and content of the audit engagement letter may vary for each entity. Information included in the audit engagement letter on the auditor’s responsibilities may be based on section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.¹¹ Paragraph .06b of this section addresses the description of the responsibilities of management. In addition to including the matters required by paragraph .10, an audit engagement letter may make reference to, for example, the following:

- Elaboration of the scope of the audit, including reference to applicable legislation, regulations, GAAS, and ethical and other pronouncements of professional bodies to which the auditor adheres
- ***Arrangements regarding the planning and performance of the audit, including the composition of the engagement~~audit~~ team***
- ***The communication of key audit matters***
- The form of any other communication ***about the*** ~~of~~ results of the audit engagement
- ~~Arrangements regarding the planning and performance of the audit, including the composition of the audit team~~
- The expectation that management will provide written representations (see also paragraph .A11)

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 that proposed SAS. 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 proposed SAS is finalized.

- ***The expectation that management will provide access to all information of which management is aware that is relevant to the preparation and fair presentation of the financial statements, including an expectation that management will provide access to information relevant to disclosures***
- The agreement of management to make available to the auditor draft financial statements, ***including all information relevant to their preparation and fair presentation, whether obtained from within or outside of the general and subsidiary ledgers (including all information relevant to the preparation and fair presentation of disclosures), and the and any accompanying other information,¹² if any,*** in time to allow the auditor to complete the audit in accordance with the proposed timetable
- The agreement of management to inform the auditor of events occurring or facts discovered subsequent to the date of the financial statements, of which management may become aware, that may affect the financial statements
- The basis on which fees are computed and any billing arrangements
- ***The city and state of the addressee in the auditor's report²***
- A request for management to acknowledge receipt of the audit engagement letter and to agree to the terms of the engagement outlined therein, as may be evidenced by their signature on the engagement letter

¹¹[Footnote omitted for purposes of this ~~proposed~~-SAS.]

¹² ***As defined in AU-C section 720, Other Information in Documents Containing Audited Financial Statements~~proposed SAS The Auditor's Responsibilities Relating to Other Information Included in Annual Reports.~~***

[All subsequent footnotes are renumbered.]

.A25 Although there is no requirement in GAAS to communicate key audit matters, the engagement letter may acknowledge that management has requested that the auditor communicate key audit matters in the auditor's report. If the terms of the audit engagement initially acknowledge that key audit matters will be communicated, but it is later decided that this will not be done, the engagement letter may need to be modified accordingly. If, after the engagement letter is signed, management requests that the auditor communicate key audit matters, the auditor may acknowledge this agreement in a new engagement letter or as an addendum to the originally signed letter.

[Paragraphs .A24–.A41 are renumbered as paragraphs .A26–.A43. The content is unchanged.]

Exhibit—Example of an Audit Engagement Letter (Ref. par. ~~.A25~~A27)

² See ~~proposed~~-SAS *Forming an Opinion and Reporting on Financial Statements*, paragraph 21.

~~A42-A44~~ The following is an example of an audit engagement letter for an audit of general purpose financial statements prepared in accordance with accounting principles generally accepted in the United States of America, as promulgated by the Financial Accounting Standards Board. This letter is not authoritative but is intended only to be a guide that may be used in conjunction with the considerations outlined in this Statement on Auditing Standards. The letter will vary according to individual requirements and circumstances and is drafted to refer to the audit of financial statements for a single reporting period. The auditor may seek legal advice about whether a proposed letter is suitable.

To the appropriate representative of those charged with governance of ABC Company:¹

[The objective and scope of the audit]

You² have requested that we audit the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, 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 are pleased to confirm our acceptance and our understanding of this audit engagement by means of this letter.

~~Our audit will be conducted~~ ***The objectives of our audit 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*** ~~with the objective of our expressing an opinion. on the financial statements.~~ ***Reasonable assurance is a high level of assurance but is not absolute assurance and therefore but is not a guarantee that an audit conducted in accordance with auditing standards generally accepted in the United States of America (GAAS) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users made on the basis of these financial statements.***

[The responsibilities of the auditor]

We will conduct our audit in accordance with ~~auditing standards generally accepted in the United States of America (GAAS).~~ ***As part of an audit in accordance with GAAS, we use-exercise professional judgment and exercisemaintain professional skepticism throughout the audit.*** ~~Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit involves~~ ***We also:***

- ~~performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of~~ ***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, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.***

- ~~In making our risk assessments, we consider~~ **Obtain an understanding of** internal control relevant to the **audit** entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.* However, we will communicate to you in writing concerning any significant deficiencies or material weaknesses in internal control relevant to the audit of the financial statements that we have identified during the audit.
- ~~An audit also includes e-Evaluating~~ the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, **as well as the overall presentation of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.**
- **Conclude, based on the audit evidence obtained, 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 for a reasonable period of time** ~~and conclude on the appropriateness of management's use of the going concern basis of accounting, when relevant, in the preparation of the financial statements.~~
- ~~, as well as evaluating the overall presentation of the financial statements.~~

Because of the inherent limitations of an audit, together with the inherent limitations of internal control, an unavoidable risk that some material misstatements may not be detected exists, even though the audit is properly planned and performed in accordance with GAAS.

[*The responsibilities of management and identification of the applicable financial reporting framework*]

Our audit will be conducted on the basis that [*management and, when appropriate, those charged with governance*]³ acknowledge and understand that they have responsibility

³ Use terminology as appropriate in the circumstance.

- a. for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America;
- b. 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; and
- c. to provide us with
 - i. access to all information of which [*management*] is aware that is relevant to the preparation and fair presentation of the financial statements such as records, documentation, and other matters;

- ii. additional information that we may request from [*management*] for the purpose of the audit; and
- iii. unrestricted access to persons within ABC Company from whom we determine it necessary to obtain audit evidence.

As part of our audit process, we will request from [*management and, when appropriate, those charged with governance*] written confirmation concerning representations made to us in connection with the audit.

[*Other relevant information*]

[*Insert other information, such as fee arrangements, billings, and other specific terms, as appropriate.*]

[Reporting]

[*Insert appropriate reference to the expected form and content of the auditor's report, including, when applicable, the reporting on other information in accordance with proposed SAS The Auditor's Responsibilities Relating to Other Information Included in Annual Reports.*³ *Example follows:*]

We will issue a written report upon completion of our audit of ABC Company's financial statements. Our report will be addressed to the board of directors of ABC Company. ~~We cannot provide assurance that an unmodified opinion will be expressed.~~ Circumstances may arise ***in which our report may differ from its expected form and content based on the results of our audit. Depending on the nature of these circumstances, in which it is necessary for us to modify our opinion, add an emphasis-of-matter or other-matter paragraph(s), or it may be necessary for us to modify our opinion, add an emphasis-of-matter paragraph or other-matter paragraph to our auditor's report, or if necessary,*** withdraw from the engagement.

We also will issue a written report on [*Insert appropriate reference to other auditor's reports expected to be issued.*] upon completion of our audit.

Please sign and return the attached copy of this letter to indicate your acknowledgment of, and agreement with, the arrangements for our audit of the financial statements including our respective responsibilities.

XYZ & Co.

Acknowledged and agreed on behalf of ABC Company by

[Signed]

³ See footnote 1.

[Name and Title]

[Date]

¹[Footnote omitted for purposes of this ~~proposed~~-SAS.]

²[Footnote omitted for purposes of this ~~proposed~~-SAS.]

** This sentence would be modified, as appropriate, in circumstances in which the auditor also has a responsibility to issue an opinion on the effectiveness of internal control over financial reporting in conjunction with the audit of the financial statements.*

³[Footnote omitted for purposes of this ~~proposed~~-SAS.]

[No further amendments to AU-C section 210.]

AU-C Section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*

[No amendments to paragraphs .01–.21. Paragraph .22 included for contextual purposes only.]

Engagement Quality Control Review

.22 The engagement quality control reviewer should perform an objective evaluation of the significant judgments made by the engagement team and the conclusions reached in formulating the auditor's report. This evaluation should involve

- a. discussion of significant findings or issues with the engagement partner;
- b. reading the financial statements and the proposed auditor's report;
- c. review of selected audit documentation relating to the significant judgments the engagement team made and the related conclusions it reached; and
- d. evaluation of the conclusions reached in formulating the auditor's report and consideration of whether the proposed auditor's report is appropriate. (Ref: par. .A26–.A32A34)

[No amendments to paragraphs .23–.A27.]

A28. When ~~proposed~~-SAS Communicating Key Audit Matters in the Independent Auditor's Report, applies, the conclusions reached by the engagement team in formulating the auditor's report include determining the following:

- *The key audit matters to be communicated*
- *The key audit matters that will not be communicated in the auditor's report in accordance with paragraph 13 of ~~proposed~~-SAS Communicating Key Audit Matters in the Independent Auditor's Report, if any*

- *If applicable, depending on the facts and circumstances of the entity and the audit, that there are no key audit matters to communicate in the auditor's report*

In addition, the reading of the proposed auditor's report in accordance with paragraph .22b includes consideration of the proposed descriptions of the matters to be included in the "Key Audit Matters" section.

[No further amendments to AU-C section 220.]

AU-C Section 230, Audit Documentation

[No amendments to paragraphs .01–.A09.]

Documentation of Significant Findings or Issues and Related Significant Professional Judgments (Ref: par. .08c)

[No amendments to paragraphs .A10–.A11]

.A12 Some examples of circumstances in which, in accordance with paragraph .08, it is appropriate to prepare audit documentation relating to the exercise of professional judgment include, when the findings, issues, and judgments are significant,

- the rationale for the auditor's conclusion when a requirement provides that the auditor *should consider* certain information or factors, and that consideration is significant in the context of the particular engagement.
- the basis for the auditor's conclusion on the reasonableness of areas of subjective judgments (for example, the reasonableness of significant accounting estimates).
- the basis for the auditor's conclusions about the authenticity of a document when further investigation (such as making appropriate use of a specialist or of confirmation procedures) is undertaken in response to conditions identified during the audit that caused the auditor to believe that the document may not be authentic.
- *when ~~proposed~~-SAS Communicating Key Audit Matters in the Independent Auditor's Report applies, the auditor's determination of the key audit matters or the determination that there are no key audit matters to be communicated, including in the extremely rare circumstances in which the auditor determines that the matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.*

[No amendments to paragraphs .A13–.A29]

.A30 Exhibit—Audit Documentation Requirements in Other AU-C Sections

The following lists the main paragraphs in other AU-C sections that contain specific documentation requirements. This list is not a substitute for knowledge of the AU-C sections:

Amendments
ASB Meeting, January 14-17, 2019

- a. Paragraphs .10, .13, and .16 of section 210, *Terms of Engagement*
- b. Paragraphs .25–.26 of section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*
- c. Paragraphs .43–.46 of section 240, *Consideration of Fraud in a Financial Statement Audit*
- d. Paragraph .28 of section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*
- e. Paragraph .20 of section 260, *The Auditor’s Communication With Those Charged With Governance*
- f. Paragraph .12 of section 265, *Communicating Internal Control Related Matters Identified in an Audit*
- g. Paragraph .14 of section 300, *Planning an Audit*
- h. Paragraph .33 of section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*
- i. Paragraph .14 of section 320, *Materiality in Planning and Performing an Audit*
- j. Paragraphs .30–.33 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*
- k. Paragraph .12 of section 450, *Evaluation of Misstatements Identified During the Audit*
- l. Paragraph .20 of section 501, *Audit Evidence—Specific Considerations for Selected Items*
- m. Paragraph .08 of section 520, *Analytical Procedures*
- n. Paragraph .22 of section 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*
- o. Paragraph .28 of section 550, *Related Parties*
- p. Paragraph .22 of section 570, *The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern*
- q. Paragraphs .49 and .64 of section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*
- r. **Paragraphs .33–.35 of section 610, Using the Work of Internal Auditors**

s. Paragraph .18 of ~~proposed~~ SAS Communicating Key Audit Matters in the Independent Auditor's Report

t. Paragraph .25 of proposed SAS The Auditor's Responsibilities Relating To Other Information Included In Annual Reports⁴

ur. Paragraph .13 of section 915, *Reports on Application of Requirements of an Applicable Financial Reporting Framework*

vs. Paragraphs .42–.43 of section 930, *Interim Financial Information*

w. Paragraphs .39–.42 of section 935, *Compliance Audits*

[No further amendments to AU-C section 230.]

⁴ See footnote 1.

AU-C Section 240, Consideration of Fraud in a Financial Statement Audit

[No amendments to paragraphs .01–.14.]

Discussion Among the Engagement Team

.15 Section 315 requires a discussion among the key engagement team members, including the engagement partner, and a determination by the engagement partner of which matters are to be communicated to those team members not involved in the discussion.⁴ This discussion should include an exchange of ideas or brainstorming among the engagement team members about how and where the entity’s financial statements (*including the individual statements and the disclosures*) might be susceptible to material misstatement due to fraud, how management could perpetrate and conceal fraudulent financial reporting, and how assets of the entity could be misappropriated. The discussion should occur setting aside beliefs that the engagement team members may have that management and those charged with governance are honest and have integrity, and should, in particular, also address (Ref: par. .A12–.A13)

...

[No amendments to paragraphs .15a–.A5.]

Characteristics of Fraud (Ref: par. 3)

A6. Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls *intentionally* using such techniques as the following:

- Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives
- Inappropriately adjusting assumptions and changing judgments used to estimate account balances
- Omitting, advancing, or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period
- ***Omitting, obscuring, or misstating disclosures required by the applicable financial reporting framework or disclosures that are necessary to achieve fair presentation***
- ~~Concealing, or not disclosing,~~ facts that could affect the amounts recorded in the financial statements
- Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity
- Altering records and terms related to significant and unusual transactions

[No amendments to paragraphs .A7–.A12.]

Discussion Among the Engagement Team (Ref: par. .15)

A13. The discussion may lead to a thorough probing of the issues, acquiring of additional evidence as necessary, and consulting with other team members and, if appropriate, specialists in or outside the firm. The discussion may include the following matters:

- *A consideration of the risk that management may attempt to present disclosures in a manner that may obscure a proper understanding of the matters disclosed (for example, by using unclear or ambiguous language)*
- A consideration of management’s involvement in overseeing employees with access to cash or other assets susceptible to misappropriation
- A consideration of any unusual or unexplained changes in behavior or lifestyle of management or employees that have come to the attention of the engagement team
- A consideration of the types of circumstances that, if encountered, might indicate the possibility of fraud
- A consideration of how an element of unpredictability will be incorporated into the nature, timing, and extent of the audit procedures to be performed
- A consideration of the audit procedures that might be selected to respond to the susceptibility of the entity’s financial statements to material misstatement due to fraud and whether certain types of audit procedures are more effective than others
- A consideration of any allegations of fraud that have come to the auditor’s attention

[No further amendments to AU-C section 240.]

AU-C Section 260, *The Auditor’s Communication With Those Charged With Governance*

[See exposure draft *Proposed Statement on Auditing Standards Omnibus Statement on Auditing Standards—2018* for additional proposed amendments to AU-C section 260.](#)

Introduction

Scope of This Section

[No amendments to paragraphs .01–.02.]

.03 Recognizing the importance of effective two-way communication in an audit of financial statements, this section provides an overarching framework for the auditor’s communication with those charged with governance and identifies some specific matters to be communicated. Additional matters to be communicated are identified in other AU-C sections (see the exhibit, “Requirements to Communicate With Those Charged With Governance in Other AU-C Sections”). In addition, section 265, *Communicating Internal Control Related Matters Identified in an Audit*, establishes specific requirements regarding the communication of significant deficiencies and material weaknesses in internal control the auditor has identified during the audit to those charged with governance. Further matters not required by generally accepted auditing standards (GAAS) may be required to be communicated by agreement with those charged with governance or management or in accordance with *law or regulation or other* external requirements. Nothing in this section precludes the auditor from communicating any other matters to those charged with governance.

[No amendments to paragraphs .04–.09.]

Matters to Be Communicated

The Auditor's Responsibilities With Regard to the Financial Statement Audit

.10 The auditor should communicate with those charged with governance the auditor's responsibilities with regard to the financial statement audit, including that (Ref: par. ~~A13-A17~~)

- a.* the auditor is responsible for forming and expressing an opinion about whether the financial statements that have been prepared by management, with the oversight of those charged with governance, are prepared, in all material respects, in accordance with the applicable financial reporting framework.
- b.* the audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

Planned Scope and Timing of the Audit

.11 The auditor should communicate with those charged with governance an overview of the planned scope and timing of the audit, ***which includes communicating about the significant risks identified by the auditor.*** (Ref: par. ~~A18A19-A22A24~~)

Significant Findings or Issues From the Audit

.12 The auditor should communicate with those charged with governance (Ref: par. ~~A23A25-A26~~)

- a.* the auditor's views about qualitative aspects of the entity's significant accounting practices, including accounting policies, accounting estimates, and financial statement disclosures. When applicable, the auditor should (Ref: par. ~~A24A27-25A29~~)
 - i.* explain to those charged with governance why the auditor considers a significant accounting practice that is acceptable under the applicable financial reporting framework not to be most appropriate to the particular circumstances of the entity and
 - ii.* determine that those charged with governance are informed about the process used by management in formulating particularly sensitive accounting estimates, including fair value estimates, and about the basis for the auditor's conclusions regarding the reasonableness of those estimates.
- b.* significant difficulties, if any, encountered during the audit. (Ref: par. ~~A26A30~~)
- c.* disagreements with management, if any. (Ref: par. ~~A28A31~~)
- d.* ***circumstances that affect the form and content of the auditor's report, if any.*** (Ref: par. ~~A32-A33~~)
- de.* other findings or issues, if any, arising ~~from~~**during** the audit that are, in the auditor's professional judgment, significant and relevant to those charged with governance regarding their responsibility to oversee the financial reporting process. (Ref: par. ~~A27.A34-A36~~)

[No amendments to paragraph .13.]

When Not All of Those Charged With Governance Are Involved in Management

.14 Unless all of those charged with governance are involved in managing the entity, the auditor also should communicate

- a. material, corrected misstatements that were brought to the attention of management as a result of audit procedures. (Ref: par. ~~.A31A39~~)
- b. significant findings or issues, ~~if any, arising from~~ during the audit that were discussed, or the subject of correspondence, with management. (Ref: par. ~~.A32A40~~)
- c. the auditor's views about significant matters that were the subject of management's consultations with other accountants on accounting or auditing matters when the auditor is aware that such consultation has occurred.
- d. written representations the auditor is requesting. (Ref. par. ~~.A33A41~~)

[No amendments to paragraphs .15-.A12.]

Matters to Be Communicated

The Auditor's Responsibilities With Regard to the Financial Statement Audit (Ref: par. .10)

.A13 The auditor's responsibilities with regard to the financial statement audit are often included in the engagement letter or other suitable form of written agreement that documents the terms of the engagement. ***Law, regulation, or the governance structure of the entity may require those charged with governance to agree upon the terms of the engagement with the auditor. When this is not the case, providing those charged with governance with a copy of that engagement letter or other suitable form of written agreement may be an appropriate way to communicate with them regarding such matters as that the following:***

- ***That*** the auditor is responsible for performing the audit in accordance with GAAS ~~and that the audit is designed to obtain reasonable, rather than absolute, assurance about whether, which is directed toward the expression of an opinion on the financial statements. The matters that GAAS require to be communicated, therefore, include significant matters arising during the audit of the financial statements as a whole are free from material misstatement that are relevant to those charged with governance in overseeing the financial reporting process:~~
- ~~an audit of financial statements includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over financial reporting.~~
- ~~the auditor is responsible for communicating significant matters related to the financial statement audit that are, in the auditor's professional judgment, relevant to the responsibilities of those charged with governance in overseeing the financial reporting process. The fact that GAAS do not require the auditor to design procedures for the purpose of identifying other matters to communicate with those charged with governance.~~
- ***That, when proposed SAS Communicating Key Audit Matters in the Independent Auditor's Report applies, the auditor is responsible for determining and communicating key audit matters in the auditor's report***
- ***That***, when applicable, the auditor is also responsible for communicating particular matters required by law or regulation, by agreement with the entity, or by additional requirements applicable to the engagement.

Auditor Independence (Ref: par. .10)

[No amendments to paragraphs .A14-.A16.]

.A17 Relevant ethical requirements may also specify particular communications to those charged with governance in circumstances in which breaches of independence requirements have been identified. For example, the AICPA Code of Professional Conduct requires the auditor to communicate with those charged with governance in writing about any breach and the action the firm has taken or proposes to take.⁴

⁴ *The “Breach of an Independence Interpretation” interpretation (AICPA, Professional Standards, ET sec. 1.298.010), under the “Independence Rule” (AICPA, Professional Standards, ET sec. 1.200.001) of the AICPA Code of Professional Conduct, addresses breaches of independence.*

[Paragraph .A17 is renumbered as paragraph .A18. The content is unchanged. Due to the arrangement of application material corresponding to paragraph .11, the following section has been reorganized.]

Planned Scope and Timing of the Audit (Ref: par. .11)

[Paragraph .A18 is renumbered and moved to paragraph .A24. No amendments to paragraph .A19.]

.A20 Communicating significant risks identified by the auditor helps those charged with governance understand those matters and why they require special audit consideration. The communication about significant risks may assist those charged with governance in fulfilling their responsibility to oversee the financial reporting process.

~~.A20.A21~~ ~~Matters communicated~~ *Other matters regarding the planned scope and timing of the audit* may include the following:

- How the auditor ~~proposes~~ plans to address the significant risks of material misstatement, whether due to fraud or error.
- *How the auditor plans to address areas of higher assessed risks of material misstatement.*
- The auditor’s approach to internal control relevant to the audit including, when applicable, whether the auditor will express an opinion on the effectiveness of internal control over financial reporting.
- The application of materiality in the context of an audit, as discussed in section 320, *Materiality in Planning and Performing an Audit. The auditor may wish to focus more broadly on the factors considered by the auditor when determining materiality for purposes of the audit, rather than on specific thresholds or amounts.*
- *The nature and extent of specialized skills or knowledge needed to perform the planned audit procedures or evaluate the audit results, including the use of an auditor’s expert.⁵*
- *When ~~proposed~~ SAS Communicating Key Audit Matters in the Independent Auditor’s Report applies, the auditor’s preliminary views about matters that may be areas of significant auditor attention in the audit and that therefore may be key audit matters.*
- *The auditor’s planned approach to addressing the implications for the individual statements and the disclosures of any significant changes within the applicable financial reporting framework or in the entity’s environment, financial condition, or activities.*
- If the entity has an internal audit function, how the auditor and the internal auditors can work together in a constructive and complementary manner, including any planned use of the work of the internal

audit function in obtaining audit evidence and the nature and extent of any planned use of internal auditors to provide direct assistance.

⁵ See *AU-C section 620, Using the Work of an Auditor's Expert*.

~~A21.A22~~ Other planning matters that may be appropriate to discuss with those charged with governance include

- the views of those charged with governance about the following matters:
 - The appropriate persons in the entity's governance structure with whom to communicate
 - The allocation of responsibilities between those charged with governance and management
 - The entity's objectives and strategies and the related business risks that may result in material misstatements
 - Matters those charged with governance consider as warranting particular attention during the audit and any areas for which they request additional procedures to be undertaken
 - Significant communications *between the entity and* ~~with~~ regulators
 - Other matters those charged with governance believe are relevant to the audit of the financial statements
- the attitudes, awareness, and actions of those charged with governance concerning
 - ~~(a)~~ the entity's internal control and its importance in the entity, including how those charged with governance oversee the effectiveness of internal control, and
 - ~~(b)~~ the detection or the possibility of fraud.
- the actions of those charged with governance in response to developments in law, accounting standards, corporate governance practices, and other related matters, *and the effect of such developments on, for example, the overall presentation, structure, and content of the financial statements, including the following:*
 - *The relevance, reliability, comparability, and understandability of the information presented in the financial statements*
 - *Whether all required information has been included in the financial statements, and whether such information has been appropriately classified, aggregated or disaggregated, and presented*
- the actions of those charged with governance in response to previous communications with the auditor.
- *if applicable, the documents that the annual report comprises and the planned manner and timing of the issuance of such documents in accordance with paragraph 9 of proposed SAS The Auditor's Responsibilities Relating to Other Information Included in Annual Reports. When the auditor expects to obtain other information after the date of the auditor's report, the discussions with those charged with governance may also include the actions that*

*may be appropriate or necessary if the auditor concludes that a material misstatement of the other information exists in other information obtained after the date of the auditor's report.*⁵

[Paragraph .A22 is renumbered as paragraph .A23. The content is unchanged.]

~~.A18~~**.A24** Care is ~~required~~ *necessary* when communicating with those charged with governance about the planned scope and timing of the audit so as not to compromise the effectiveness of the audit, particularly when some or all of those charged with governance are involved in managing the entity. For example, communicating the nature and timing of detailed audit procedures may reduce the effectiveness of those procedures by making them too predictable. Certain factors described in paragraph .A39~~47~~ may be relevant in determining the nature and extent of this communication.

Significant Findings From the Audit (Ref: par. .12)

[Paragraph .A23 is renumbered as paragraph .A25. The content is unchanged.]

.A26 When ~~proposed~~-SAS Communicating Key Audit Matters in the Independent Auditor's Report applies, the communications with those charged with governance required by paragraph .12, as well as the communication about the significant risks identified by the auditor required by paragraph .11, are particularly relevant to the auditor's determination of matters that required significant auditor attention and which therefore may be key audit matters.⁶

⁶ Paragraphs 9–10 of ~~proposed~~-SAS Communicating Key Audit Matters in the Independent Auditor's Report.

[Subsequent footnote renumbered.]

Qualitative Aspects of the Entity's Significant Accounting Practices (Ref: par. .12a)

~~.A24~~**.A27** Financial reporting frameworks ordinarily allow for the entity to make accounting estimates and judgments about accounting policies and financial statement disclosures, *for example, the use of key assumptions in the development of accounting estimates for which there is significant measurement uncertainty. In addition, law, regulation, or financial reporting frameworks may require disclosure of a summary of significant accounting policies or make reference to "critical accounting estimates" or "critical accounting policies and practices" to identify and provide additional information to users about the most difficult, subjective, or complex judgments made by management in preparing the financial statements.*

.A28 As a result, the auditor's views on the subjective aspects of the financial statements may be particularly relevant to those charged with governance in discharging their responsibilities for oversight of the financial reporting process. For example, in relation to the matters described in paragraph .A27, those charged with governance may be interested in the auditor's evaluation of the adequacy of disclosures of the estimation uncertainty relating to accounting estimates that give rise to significant risks and the quality of the disclosures. Open and constructive communication about qualitative aspects of the entity's significant accounting practices may *also* include comment on the acceptability of significant accounting practices *and the quality of the disclosures*. The appendix, "Qualitative Aspects of Accounting Practices," identifies matters that may be included in this communication.

⁵ See footnote 1.

[Paragraph .A25 is renumbered as paragraph .A29. The content is unchanged.]

Significant Difficulties Encountered During the Audit (Ref: par. .12b)

.A26A30 Significant difficulties encountered during the audit may include matters such as

- significant delays in ~~management providing required information~~ **by management, the unavailability of entity personnel, or an unwillingness by management to provide information necessary to perform the auditor's procedures.**
- an ~~unnecessarily~~ **unreasonably** brief time within which to complete the audit.
- extensive unexpected effort required to obtain sufficient appropriate audit evidence.
- the unavailability of expected information.
- restrictions imposed on the auditor by management.
- management's unwillingness to ~~provide information about management's plans for dealing with the adverse effects of the conditions or events that lead the auditor to believe there is substantial doubt about~~ **perform or extend its evaluation of** the entity's ability to continue as a going concern **to meet the period of time required by the applicable financial reporting framework when requested.**

In some circumstances, such difficulties may constitute a scope limitation that leads to a modification of the auditor's opinion.

Disagreements With Management (Ref: par. .12c)

[Paragraph .A27 renumbered and moved to paragraph .A34. Paragraph .A28 is renumbered as paragraph .A31. The content is unchanged.]

Circumstances That Affect the Form and Content of the Auditor's Report (Ref: par. .12d)

.A32 *AU-C section 210, Terms of Engagement, requires the auditor to agree upon the terms of the audit engagement with management or those charged with governance, as appropriate.⁸ The agreed terms of the audit engagement are required to be recorded in an audit engagement letter or other suitable form of written agreement and include, among other things, reference to the expected form and content of the auditor's report.⁹ As explained in paragraph .A13, if the terms of engagement are not agreed upon with those charged with governance, the auditor may provide those charged with governance with a copy of the engagement letter in order to communicate about matters relevant to the audit. The communication required by paragraph .12d is intended to inform those charged with governance about circumstances in which the auditor's report may differ from its expected form and content or may include additional information about the audit that was performed.*

⁸ Paragraph .09 of AU-C section 210, Terms of Engagement.

⁹ Paragraph .10 of AU-C section 210.

.A33 *Circumstances in which the auditor is required or may otherwise consider it necessary to include additional information in the auditor's report in accordance with GAAS, and for which communication with those charged with governance is required, include the following:*

- *The auditor expects to modify the opinion in the auditor's report in accordance with ~~proposed~~-SAS Modifications to the Opinion in the Independent Auditor's Report.¹⁰*

- *A “Going Concern” section is included in the auditor’s report in accordance with ~~proposed amendments to~~ AU-C section 570, The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern.¹¹*
- *Key audit matters are communicated in accordance with ~~proposed~~ SAS Communicating Key Audit Matters in the Independent Auditor’s Report.¹²*
- *The auditor considers it necessary to include an emphasis-of-matter paragraph or other-matter paragraph in accordance with ~~proposed~~ SAS Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor’s Report,¹³ or is required to do so by other AU-C sections.*

In such circumstances, the auditor may consider it useful to provide those charged with governance with a draft of the auditor’s report to facilitate a discussion of how such matters will be addressed in the auditor’s report.

¹⁰ *Paragraph 31 of ~~proposed~~ SAS Modifications to the Opinion in the Independent Auditor’s Report.*

¹¹ *Paragraph .24 of ~~proposed amendments to~~ AU-C section 570, The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern.*

¹² *Paragraph 16 of ~~proposed~~ SAS Communicating Key Audit Matters in the Independent Auditor’s Report.*

¹³ *Paragraph 12 of ~~proposed~~ SAS Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor’s Report.*

Other Findings or Issues

~~A27A34~~ The auditor may become aware that the entity is subject to an audit requirement that is not encompassed in the terms of the engagement. The communication to those charged with governance that an audit conducted in accordance with GAAS may not satisfy the relevant legal, regulatory, or contractual requirements may be necessary if, for example, an entity engages an auditor to perform an audit of its financial statements in accordance with GAAS and the auditor becomes aware that by law, regulation, or contractual agreement the entity also is required to have an audit performed in accordance with one or more of the following:

- a. *Government Auditing Standards*
- b. ~~OMB Circular A-133, Audits of States, Local Governments~~ **Title 2 U.S. Code of Federal Regulations Part 200, Uniform Administration Requirements, Cost Principles, and Non-Profit Organizations Audit Requirements for Federal Awards**
- c. *Other compliance audit requirements, such as state or local laws or program-specific audits under federal audit guides*

Other Significant Matters Relevant to the Financial Reporting Process (Ref: Par. .12e)

~~.A35~~ *AU-C section 300, Planning an Audit,¹⁴ notes that, as a result of unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy and audit plan and thereby the resulting planned nature, timing, and extent of further audit procedures, based on the revised consideration of assessed risks. The auditor may communicate with those charged with governance about such matters as, for example, an update to initial discussions about the planned scope and timing of the audit.*

¹⁴ *Paragraph .A15 of AU-C section 300, Planning an Audit.*

.A36 *To the extent not already addressed by the requirements in paragraph .12a–d and related application material, the auditor may consider communicating about other matters discussed with, or considered by, the engagement quality control reviewer, if one has been appointed, in accordance with AU-C section 220, Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.*¹⁵

¹⁵ *Paragraphs .21–.22 of AU-C section 220, Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards.*

[Paragraphs .A29–.A31 are renumbered as paragraphs .A37–.A39. The content is unchanged.]

Significant Findings or Issues Discussed or Subject to Correspondence With Management (Ref: par. .14b)

.A32A40 Significant findings or issues discussed, or the subject of correspondence, with management may include matters such as

- *significant events or transactions that occurred during the year.*
- business conditions affecting the entity and business plans and strategies that may affect the risks of material misstatement.
- discussions or correspondence in connection with the initial or recurring engagement of the auditor including, among other matters, any discussions or correspondence regarding accounting practices or the application of auditing standards.

[Paragraphs .A33–.A38 are renumbered as paragraphs .A41–.A46. The content is unchanged.]

Forms of Communication (Ref: par. .16)

[Paragraph .A39 is renumbered as paragraph .A47. The content is unchanged.]

.A40A48 In addition to the significance of a particular matter, the form of communication (for example, whether to communicate orally or in writing, the extent of detail or summarization in the communication, and whether to communicate in a formal or informal manner) may be affected by factors such as

- *whether a discussion of the matter will be included in the auditor’s report. For example, when key audit matters are communicated in the auditor’s report, the auditor may consider it necessary to communicate in writing about the matters determined to be key audit matters.*
- whether the matter has been satisfactorily resolved.
- whether management has previously communicated the matter.
- the size, operating structure, control environment, and legal structure of the entity being audited.
- *in the case of an audit of special purpose financial statements, whether the auditor also audits the entity’s general purpose financial statements.*
- legal or regulatory requirements that may require a written communication with those charged with governance.
- the expectations of those charged with governance, including arrangements made for periodic meetings or communications with the auditor.

- the amount of ongoing contact and dialogue the auditor has with those charged with governance.
 - whether there have been significant changes in the membership of a governing body.
- ~~in the case of an audit of special purpose financial statements, whether the auditor also audits the entity's general purpose financial statements.~~

[Paragraph .A41 is renumbered as paragraph .A49. The content is unchanged.]

Timing of Communications (Ref: par. .18)

~~A42-A50.~~—***The Timely communication throughout the audit contributes to the achievement of robust two-way dialogue between those charged with governance and the auditor. However, the*** appropriate timing for communications will vary with the circumstances of the engagement. Considerations include the significance and nature of the matter, [the importance of the matter to those charged with governance](#), and the action expected to be taken by those charged with governance. ~~The auditor may consider communicating~~ ***For example:***

- ***Communications regarding*** planning matters ***may often be made*** early in the audit engagement and, for an initial engagement, as part of the terms of the engagement.
- ***It may be appropriate to communicate*** significant difficulties encountered during the audit as soon as practicable if those charged with governance are able to assist the auditor in overcoming the difficulties or if the difficulties are likely to lead to a modified opinion.
- ***Communications regarding independence may be appropriate whenever significant judgments are made about threats to independence and related safeguards.***
- ***When ~~proposed~~-SAS Communicating Key Audit Matters in the Independent Auditor's Report applies, the auditor may communicate preliminary views about key audit matters when discussing the planned scope and timing of the audit (see paragraph .A21); the auditor may also have more frequent communications to further discuss such matters when communicating about significant audit findings.***

The following are examples of matters for which communication with those charged with governance may be more important prior to issuance of the auditor's report:

- ***Communications regarding uncorrected misstatements accumulated by the auditor and the effect that they, individually or in the aggregate, may have on the opinion in the auditor's report, including possible implications with respect to future financial statements.***
- ***[Communications regarding circumstances or relationships to which the auditor gave significant consideration relating to independence in reaching the conclusion that independence has not been impaired.](#)***
- ***Communications regarding findings from the audit, including the auditor's views about the qualitative aspects of the entity's accounting practices.***
- ***When ~~proposed~~-SAS Communicating Key Audit Matters in the Independent Auditor's Report applies, the matters planned to be included in the auditor's report.***

[Paragraphs .A43–.A48 are renumbered as paragraphs .A51–.A56. The content is unchanged.]

Exhibit—Requirements to Communicate With Those Charged With Governance in Other AU-C Sections

~~A49-A57~~ Requirements for the auditor to communicate with those charged with governance are included in other AU-C sections. This section does not change the requirements in

- a. paragraph .17 of section 210, *Terms of Engagement*
- b. paragraphs .21, .38ci, and .39–.41 of section 240, *Consideration of Fraud in a Financial Statement Audit*
- c. paragraphs .14, .18, and .21–.23 of section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*
- d. paragraph .11 of section 265, *Communicating Internal Control Related Matters Identified in an Audit*
- e. paragraph .27 of section 550, *Related Parties*
- f. paragraphs .10b–c, .12a, .15a, .17a, and .18 of section 560, *Subsequent Events and Subsequently Discovered Facts*
- g. paragraph ~~.1928~~ of section 570, *The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern*
- h. paragraphs .45–.48 of section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*
- i. **paragraph .28 of section 610, Using the Work of Internal Auditors**
- j. **paragraph 17 of ~~proposed~~-SAS Communicating Key Audit Matters in the Independent Auditor’s Report**
- ~~i.k.~~ paragraphs 12, 14, ~~.2024~~, and ~~.2931~~ of section ~~proposed~~-SAS *Modifications to the Opinion in the Independent Auditor’s Report*
- ~~j.l.~~ paragraph ~~.0912~~ of section ~~proposed~~-SAS *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor’s Report*

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~~*km.*~~ paragraphs ~~.08~~.08, ~~12~~.12, ~~15~~.15, and ~~18~~.18 of ~~section~~ ~~section~~ ~~proposed SAS 720~~, *Other Information in Documents Containing Audited Financial Statements* ~~The Auditor's Responsibilities Relating to Other Information Included in Annual Reports~~⁶

~~*ln.*~~ paragraph .06 of section 730, *Required Supplementary Information*

~~*mq.*~~ paragraphs .23–.28 of section 930, *Interim Financial Information*

~~*np.*~~ paragraphs .36–.37 of section 935, *Compliance Audits*

⁶~~See footnote 1.~~

AU-C Section 300, *Planning an Audit*

Requirements

[No amendments to paragraphs .01–.A14.]

Planning Activities

...

The Audit Plan (Ref: par. .09)

A15. Determining the nature, timing, and extent of planned risk assessment procedures, and further audit procedures, as they relate to disclosures is important in light of both the wide range of information and the level of detail that may be encompassed in those disclosures. Further, certain disclosures may contain information that is obtained from outside of the general and subsidiary ledgers, which may also affect the assessed risks and the nature, timing, and extent of audit procedures to address them.

A16. Consideration of disclosures early in the audit assists the auditor in giving appropriate attention to, and planning adequate time for, addressing disclosures in the same way as classes of transactions, events, and account balances are addressed. Early consideration may also help the auditor to determine the effects on the audit of the following:

- ***Significant new or revised disclosures required as a result of changes in the entity’s environment, financial condition, or activities (for example, disclosures about discontinued operations or a significant business combination)***
- ***Significant new or revised disclosures arising from changes in the applicable financial reporting framework***
- ***The need for the involvement of an auditor’s expert to assist with audit procedures related to particular disclosures (for example, disclosures related to pension or other retirement benefit obligations)***
- ***Matters relating to disclosures that the auditor may wish to discuss with those charged with governance³***

³ Paragraph .A13 of section 260, The Auditor’s Communication With Those Charged With Governance.

[Paragraphs .A15–.A24 are renumbered as paragraphs .A17–.A26. The content is unchanged.]

Appendix—Considerations in Establishing the Overall Audit Strategy (Ref: par. .07–.08 and .A9–.A12)

.A25.A27

Significant Factors, Preliminary Engagement Activities, and Knowledge Gained on Other Engagements

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The following examples illustrate significant factors, preliminary engagement activities, and knowledge gained on other engagements:

- The determination of materiality, in accordance with section 320, *Materiality in Planning and Performing an Audit*, and, when applicable, the following:
 - The determination of materiality for components and communication thereof to component auditors in accordance with section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*
 - The preliminary identification of significant components and material classes of transactions, account balances, and disclosures
- Preliminary identification of areas in which there may be a higher risk of material misstatement
- The effect of the assessed risk of material misstatement at the overall financial statement level on direction, supervision, and review
- The manner in which the auditor emphasizes to engagement team members the need to maintain a questioning mind and exercise professional skepticism in gathering and evaluating audit evidence
- Results of previous audits that involved evaluating the operating effectiveness of internal control, including the nature of identified deficiencies and action taken to address them
- The discussion of matters that may affect the audit with firm personnel responsible for performing other services to the entity
- Evidence of management's commitment to the design, implementation, and maintenance of sound internal control, including evidence of appropriate documentation of such internal control
- ***Changes within the applicable financial reporting framework, such as changes in accounting standards, which may involve significant new or revised disclosures***
- Volume of transactions, which may determine whether it is more efficient for the auditor to rely on internal control
- Importance attached to internal control throughout the entity to the successful operation of the business
- ***The processes management uses to identify and prepare the disclosures required by the applicable financial reporting framework, including disclosures containing information that is obtained from outside of the general and subsidiary ledgers***
- Significant business developments affecting the entity, including changes in IT and business processes; changes in key management; and acquisitions, mergers, and divestments
- Significant industry developments, such as changes in industry regulations and new reporting requirements

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- ~~Significant changes in the financial reporting framework, such as changes in accounting standards.~~
- Other significant relevant developments, such as changes in the legal environment affecting the entity

AU-C Section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*

[No amendments to paragraphs .01–.18.]

The Required Understanding of the Entity and Its Environment, Including the Entity’s Internal Control

The Entity’s Internal Control

Components of Internal Control

.19 *The information system, including the related business processes relevant to financial reporting and communication.* The auditor shall obtain an understanding of the information system, including the related business processes relevant to financial reporting, including the following areas:

- a. The classes of transactions in the entity’s operations that are significant to the financial statements.
- b. The procedures within both IT and manual systems by which those transactions are initiated, authorized, recorded, processed, corrected as necessary, transferred to the general ledger, and reported in the financial statements.
- c. The related accounting records supporting information and specific accounts in the financial statements that are used to initiate, authorize, record, process, and report transactions. This includes the correction of incorrect information and how information is transferred to the general ledger. The records may be in either manual or electronic form.
- d. How the information system captures events and conditions, other than transactions, that are significant to the financial statements.
- e. The financial reporting process used to prepare the entity’s financial statements, including significant accounting estimates and disclosures.
- f. Controls surrounding journal entries, including nonstandard journal entries used to record nonrecurring, unusual transactions, or adjustments. (~~Ref: par. .A92–.A96~~)

This understanding of the information system relevant to financial reporting should include relevant aspects of that system relating to information disclosed in the financial statements that is obtained from within or outside of the general and subsidiary ledgers. (Ref: par. .A92–.A96)

[No amendments to paragraphs .20–.26.]

Identifying and Assessing the Risk of Material Misstatement

.27 For this purpose, the auditor should

- a. identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures (***including the quantitative and qualitative aspects of such disclosures***) in the financial statements; (Ref: par. ~~.A134–A135.A139–A143~~)
- b. assess the identified risks and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions;
- c. relate the identified risks to what can go wrong at the relevant assertion level, taking account of relevant controls that the auditor intends to test; and (Ref: par. ~~.A136–A138.A144–A146~~)
- d. consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement. (***Ref: par. .A147***)

[No amendments to paragraphs .28–.33.]

Application and Other Explanatory Material

Risk Assessment Procedures and Related Activities (Ref: para. 5)

.A1 Obtaining an understanding of the entity and its environment, including the entity's internal control (referred to hereafter as an understanding of the entity), is a continuous, dynamic process of gathering, updating, and analyzing information throughout the audit. The understanding of the entity establishes a frame of reference within which the auditor plans the audit and exercises professional judgment throughout the audit when, for example

- assessing risks of material misstatement of the financial statements;
- determining materiality in accordance with section 320, *Materiality in Planning and Performing an Audit*;
- considering the appropriateness of the selection and application of accounting policies and the adequacy of financial statement disclosures;
- Identifying areas ***relating to amounts or disclosures in the financial statements*** for which special audit consideration may be necessary (for example, related party transactions, ~~the appropriateness of or management's use of the~~ ***evaluation of the entity's ability to continue as a going concern assumption***; or ***when*** considering the business purpose of transactions);
- identifying areas for which special audit consideration may be necessary (for example, related party transactions, the appropriateness of management's use of the going concern assumption, considering the business purpose of transactions, or the existence of complex and unusual transactions);
- developing expectations for use when performing analytical procedures;

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- responding to the assessed risks of material misstatement, including designing and performing further audit procedures to obtain sufficient appropriate audit evidence; and
- evaluating the sufficiency and appropriateness of audit evidence obtained, such as the appropriateness of assumptions and management’s oral and written representations.

[No amendments to paragraphs .A2–.A18.]

Information Obtained in Prior Periods (Ref: Par. 10)

.A19 The auditor’s previous experience with the entity and audit procedures performed in previous audits may provide the auditor with information about such matters as

- past misstatements and whether they were corrected on a timely basis.
- the nature of the entity and its environment and the entity’s internal control (including deficiencies in internal control).
- significant changes that the entity or its operations may have undergone since the prior financial period, which may assist the auditor in gaining a sufficient understanding of the entity to identify and assess risks of material misstatement.
- *those particular types of transactions and other events or account balances (and related disclosures) where the auditor experienced difficulty in performing the necessary audit procedures, for example, due to their complexity.*

.A20 *As part of the discussion among the engagement team required by paragraph .11, consideration of the disclosure requirements of the applicable financial reporting framework assists in identifying early in the audit where there may be risks of material misstatement related to disclosures. Examples of matters the engagement team may discuss include the following:*

- *Changes in financial reporting requirements that may result in significant new or revised disclosures*
- *Changes in the entity’s environment, financial condition, or activities that may result in significant new or revised disclosures, for example, a significant business combination in the period under audit*
- *Disclosures for which obtaining sufficient appropriate audit evidence may have been difficult in the past*
- *Disclosures about complex matters, including those involving significant management judgment regarding what information to disclose*

[Paragraphs .A20–.A26 are renumbered as paragraphs .A21–A27. The content is unchanged.]

The Required Understanding of the Entity and Its Environment, Including the Entity’s Internal Control

The Entity and Its Environment

Industry, Regulatory, and Other External Factors (Ref: par. 12a)

~~A27-A28~~ *Regulatory Factors.* Relevant regulatory factors include the regulatory environment. The regulatory environment encompasses, among other matters, the applicable financial reporting framework and the legal and political environment. Examples of matters the auditor may consider include the following:

- Accounting principles and industry-specific practices
- Regulatory framework for a regulated industry, **including requirements for disclosures**
- Laws and regulations that significantly affect the entity’s operations, including direct supervisory activities
- Taxation (corporate and other)
- Government policies currently affecting the conduct of the entity’s business, such as monetary (including foreign exchange controls), fiscal, financial incentives (for example, government aid programs), and tariffs or trade restrictions policies
- Environmental requirements affecting the industry and the entity’s business

[Paragraphs .A28–.A29 are renumbered as paragraphs .A29–.A30. The content is unchanged.]

Nature of the Entity (Ref: par. 12b)

~~A30-A31~~ An understanding of the nature of an entity enables the auditor to understand such matters as

- whether the entity has a complex structure (for example, with subsidiaries or other components in multiple locations). Complex structures often introduce issues that may give rise to risks of material misstatement. Such issues may include whether goodwill, joint ventures, investments, or investments in entities formed to accomplish specific objectives are accounted for **and disclosed** appropriately.
- the ownership, and relationships between owners and other people or entities. This understanding assists in determining whether related party transactions have been **appropriately identified, and accounted for, appropriately and adequately disclosed in the financial statements**. Section 550, *Related Parties*, addresses the auditor’s considerations relevant to related parties.

~~A31-A32~~ Examples of matters that the auditor may consider when obtaining an understanding of the nature of the entity include

- business operations such as
...
- investments and investment activities such as
...
- financing and financing activities such as
...
- financial reporting **practices** such as
 - accounting principles and industry-specific practices, including **for** industry-specific significant categories **classes of transactions, account balances, and related disclosures in the financial**

statements (for example, loans and investments for banks or research and development for pharmaceuticals).

- revenue recognition ~~practices~~.
- accounting for fair values.
- foreign currency assets, liabilities, and transactions.
- accounting for unusual or complex transactions, including those in controversial or emerging areas (for example, accounting for stock-based compensation).

[Paragraphs .A32–.A81 are renumbered as paragraphs .A33–A82. The content is unchanged.]

Components of Internal Control—Control Environment (Ref: par. 15)

.A82 *Effect of the control environment on the assessment of the risks of material misstatement.* Some elements of an entity’s control environment have a pervasive effect on assessing the risks of material misstatement. For example, an entity’s control consciousness is influenced significantly by those charged with governance, because one of their roles is to counterbalance pressures on management in relation to financial reporting that may arise from market demands or remuneration schemes. The effectiveness of the design of the control environment in relation to participation by those charged with governance is therefore influenced by such matters as

- their independence from management and their ability to evaluate the actions of management.
- whether they understand the entity’s business transactions.
- the extent to which they evaluate whether the financial statements are prepared in accordance with the applicable financial reporting framework, ***including whether the financial statements include adequate disclosures.***

[Paragraphs .A83–.A92 are renumbered as paragraphs .A84–A93. The content is unchanged.]

Components of Internal Control—The Information System, Including Related Business Processes Relevant to Financial Reporting and Communication

.A94 *Financial statements may contain information that is obtained from outside of the general and subsidiary ledgers. Examples of such information may include the following:*

- ***Information obtained from lease agreements disclosed in the financial statements, such as renewal options or future lease payments***
- ***Information disclosed in the financial statements that is produced by an entity’s risk management system***
- ***Fair value information produced by management’s experts and disclosed in the financial statements***
- ***Information disclosed in the financial statements that has been obtained from models or from other calculations used to develop estimates recognized or disclosed in the financial statements, including information relating to the underlying data and assumptions used in those models, such as the following:***
 - ***Assumptions developed internally that may affect an asset’s useful life***

– *Data, such as interest rates, that are affected by factors outside the control of the entity*

- *Information disclosed in the financial statements about sensitivity analyses derived from financial models that demonstrates that management has considered alternative assumptions*
- *Information recognized or disclosed in the financial statements that has been obtained from an entity's tax returns and records*
- *Information disclosed in the financial statements that has been obtained from analyses prepared to support management's evaluation of the entity's ability to continue as a going concern, such as disclosures, if any, related to events or conditions that have been identified that raise substantial doubt about the entity's ability to continue as a going concern¹⁴*

¹⁴ See paragraphs .21–.22 of section 570.

.A95 The understanding of the information system relevant to financial reporting required by paragraph .19 of this section (including the understanding of relevant aspects of that system relating to information disclosed in the financial statements that is obtained from within or outside of the general and subsidiary ledgers) is a matter of the auditor's professional judgment. For example, certain amounts or disclosures in the entity's financial statements (such as disclosures about credit risk, liquidity risk, and market risk) may be based on information obtained from the entity's risk management system. However, the auditor is not required to understand all aspects of the risk management system and uses professional judgment in determining the necessary understanding.

[Paragraphs .A93–.A95 are renumbered as paragraphs .A96–.A98. The content is unchanged. Subsequent footnotes are renumbered.]

~~A96.~~**A99** *Considerations specific to smaller, less complex entities. (Ref: par. 19). The information system, and related business processes, relevant to financial reporting in small entities, including relevant aspects of that system relating to information disclosed in the financial statements that is obtained from within or outside of the general and subsidiary ledgers, are is likely to be less sophisticated than in larger entities, but their its role is just as significant. Small entities with active management involvement may not need extensive descriptions of accounting procedures, sophisticated accounting records, or written policies. Understanding the entity's information systems relevant to financial reporting and processes may therefore be easier in an audit of smaller entities; and may be more dependent on inquiry than on review of documentation. The need to obtain an understanding, however, remains important.*

[Paragraphs .A97–.A102 are renumbered as paragraphs .A100–.A105. The content is unchanged.]

Components of Internal Control—Control Activities (Ref: par. .21)

.A106 Control activities relevant to the audit may include controls established by management that address risks of material misstatement related to disclosures not being prepared in accordance with the applicable financial reporting framework, in addition to controls that address risks related to account balances and transactions. Such control activities may relate to information included in the financial statements that is obtained from outside of the general and subsidiary ledgers.

[Paragraphs .A103–.A122 are renumbered as paragraphs .A107–.A126. The content is unchanged.]

Identifying and Assessing the Risks of Material Misstatement

Assessment of Risks of Material Misstatement at the Financial Statement Level (Ref: par. .26a)

~~A123~~**A127** Risks at the financial statement level may derive, in particular, from a deficient control environment (although these risks may also relate to other factors, such as declining economic conditions). For example, deficiencies such as ~~management's~~ **a lack of *management* competence *or a lack of oversight over the preparation and fair presentation of the financial statements*** may have a more pervasive effect on the financial statements and may require an overall response by the auditor.

[Paragraphs .A124–.A126 are renumbered as paragraphs .A128–.A130. The content is unchanged.]

The Use of Assertions

~~A127~~**A131** In representing that the financial statements are in accordance with the applicable financial reporting framework, management implicitly or explicitly makes assertions regarding—the recognition, measurement, **and presentation of classes of transactions and events, account balances,** and disclosures ~~of the various elements of financial statements and related disclosures.~~

[Paragraph .A129 is renumbered and moved to paragraph .A132.]

~~A129~~**A132** The auditor may use the assertions as described ~~above~~ **in paragraph .A133a–b** or may express them differently provided all aspects described ~~above~~ **in paragraph .A133** have been covered. For example, the auditor may choose to combine the assertions about **classes of transactions and events, and related disclosures,** with the assertions about account balances, **and related disclosures.** As another example, there may not be a separate assertion related to cutoff of transactions and events when the occurrence and completeness assertions include appropriate consideration of recording transactions in the correct accounting period.

Assertions About Classes of Transactions, Account Balances, and Related Disclosures

~~A128~~**A133** Assertions used by the auditor ~~to~~ **in considering** the different types of potential misstatements that may occur **may** fall into the following ~~three categories and may take the following forms:~~

- a. Assertions about classes of transactions and events, **and related disclosures,** for the period under audit, such as the following:
 - i. **Occurrence.** Transactions and events that have been recorded **or disclosed,** have occurred, and **such transactions and events** pertain to the entity.
 - ii. **Completeness.** All transactions and events that should have been recorded have been recorded, **and all related disclosures that should have been included in the financial statements have been included.**
 - iii. **Accuracy.** Amounts and other data relating to recorded transactions and events have been recorded appropriately, **and related disclosures have been appropriately measured and described.**
 - iv. **Cutoff.** Transactions and events have been recorded in the correct accounting period.
 - v. **Classification.** Transactions and events have been recorded in the proper accounts.

- vi. **Presentation.** *Transactions and events are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.*
- b. Assertions about account balances, **and related disclosures**, at the period end, such as the following:
- i. *Existence.* Assets, liabilities, and equity interests exist.
 - ii. *Rights and obligations.* The entity holds or controls the rights to assets, and liabilities are the obligations of the entity.
 - iii. *Completeness.* All assets, liabilities and equity interests that should have been recorded have been recorded, **and all related disclosures that should have been included in the financial statements have been included.**
 - iv. **Accuracy, valuation and allocation.** Assets, liabilities, and equity interests ~~are~~ **have been included** in the financial statements at appropriate amounts, ~~and~~ any resulting valuation or allocation adjustments ~~are~~ **have been** appropriately recorded, **and related disclosures have been appropriately measured and described.**
 - v. **Classification.** *Assets, liabilities, and equity interests have been recorded in the proper accounts.*
 - vi. **Presentation.** *Assets, liabilities, and equity interests are appropriately aggregated or disaggregated and clearly described, and related disclosures are relevant and understandable in the context of the requirements of the applicable financial reporting framework.*
- ~~e. Assertions about presentation and disclosure, such as the following:~~
- ~~i. Occurrence and rights and obligations—disclosed events, transactions, and other matters have occurred and pertain to the entity.~~
 - ~~ii. Completeness— all disclosures that should have been included in the financial statements have been included.~~
 - ~~iii. Classification and understandability— financial information is appropriately presented and described, and disclosures are clearly expressed.~~
 - ~~iv. Accuracy and valuation— financial and other information are disclosed fairly and at appropriate amounts.~~

Assertions About Other Disclosures

.A134 The assertions described in paragraph .A133a–b, adapted as appropriate, may also be used by the auditor in considering the different types of potential misstatements that may occur in disclosures not directly related to recorded classes of transactions, events, or account balances. As an example of such a disclosure, the entity may be required to describe its exposure to risks arising from financial instruments, including how the risks arise; the objectives, policies, and processes for managing the risks; and the methods used to measure the risks.

[Paragraphs .A130–.A133 are renumbered as paragraphs .A135–A138. The content is unchanged.]

Process of Identifying Risks of Material Misstatement (Ref: par. .27a)

~~A134.~~**A139** Information gathered by performing risk assessment procedures, including the audit evidence obtained in evaluating the design of controls and determining whether they have been implemented, is used as audit evidence to support the risk assessment. The risk assessment determines the nature, timing, and extent of further audit procedures to be performed. *In identifying the risks of material misstatement in the financial statements, the auditor exercises professional skepticism in accordance with section 200.*⁵

⁵ *Paragraph .17 of section 200.*

~~A135.~~**A140** Appendix C provides examples of conditions and events that may indicate the existence of risks of material misstatement, *including risks of material misstatement relating to disclosures.*

*.A141 As explained in section 320,⁶ materiality and audit risk are considered when identifying and assessing the risks of material misstatement in classes of transactions, account balances, and disclosures. The auditor's determination of materiality is a matter of professional judgment and is affected by the auditor's perception of the financial reporting needs of users of the financial statements.*⁷

⁶ *Paragraph .A1 of section 320.*

⁷ *Paragraph .04 of section 320.*

.A142 The auditor's consideration of disclosures in the financial statements when identifying risks includes quantitative and qualitative disclosures, the misstatement of which could be material (that is, in general, misstatements are considered to be material if they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements as a whole). Depending on the circumstances of the entity and the engagement, examples of disclosures that will have qualitative aspects and that may be relevant when assessing the risks of material misstatement include disclosures about the following:

- *Liquidity and debt covenants of an entity in financial distress*
- *Events or circumstances that have led to the recognition of an impairment loss*
- *Key sources of estimation uncertainty, including assumptions about the future*
- *The nature of a change in accounting policy, and other relevant disclosures required by the applicable financial reporting framework, where, for example, new financial reporting requirements are expected to have a significant impact on the financial position and financial performance of the entity*
- *Share-based payment arrangements, including information about how any amounts recognized were determined, and other relevant disclosures*
- *Related parties and related party transactions*
- *Sensitivity analysis, including the effects of changes in assumptions used in the entity's valuation techniques intended to enable users to understand the underlying measurement uncertainty of a recorded or disclosed amount*

Considerations Specific to Smaller Entities

.A143 Disclosures in the financial statements of smaller entities may be less detailed or less complex (for example, some financial reporting frameworks allow smaller entities to provide fewer disclosures in the financial statements). However, this does not relieve the auditor of the responsibility to obtain an understanding of the entity and its environment, including internal control, as it relates to disclosures.

[Paragraphs .A136–.A138 are renumbered as paragraphs .A144–.A146. The content is unchanged.]

Material Misstatements (Ref: par. 27d)

.A147 Potential misstatements in individual statements and disclosures may be judged to be material due to size, nature, or circumstances.

[Paragraphs .A139–.A157 are renumbered as paragraphs .A148–.A166. The content is unchanged.]

Appendix C—Conditions and Events That May Indicate Risks of Material Misstatement (Ref: par. .A40A41 and .A135A140)

.A158A167

The following are examples of conditions and events that may indicate the existence of risks of material misstatement *in the financial statements*. The examples provided cover a broad range of conditions and events; however, not all conditions and events are relevant to every audit engagement and the list of examples is not necessarily complete.

- Operations in regions that are economically unstable (for example, countries with significant currency devaluation or highly inflationary economies)
- Operations exposed to volatile markets (for example, futures trading)
- Operations that are subject to a high degree of complex regulation
- Going concern and liquidity issues, including loss of significant customers
- Constraints on the availability of capital and credit
- Changes in the industry in which the entity operates
- Changes in the supply chain
- Developing or offering new products or services or moving into new lines of business
- Expanding into new locations
- Changes in the entity, such as large acquisitions or reorganizations or other unusual events
- Entities or business segments likely to be sold
- The existence of complex alliances and joint ventures

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- Use of off balance sheet finance, investments in entities formed to accomplish specific objectives, and other complex financing arrangements
- Significant transactions with related parties
- Lack of personnel with appropriate accounting and financial reporting skills
- Changes in key personnel, including departure of key executives
- Deficiencies in internal control, especially those not addressed by management
- ***Incentives for management and employees to engage in fraudulent financial reporting***
- Inconsistencies between the entity's IT strategy and its business strategies
- Changes in the IT environment
- Installation of significant new IT systems related to financial reporting
- Inquiries into the entity's operations or financial results by regulatory or government bodies
- Past misstatements, history of errors, or a significant amount of adjustments at period-end
- Significant amount of nonroutine or nonsystematic transactions, including intercompany transactions and large revenue transactions at period-end
- Transactions that are recorded based on management's intent (for example, debt refinancing, assets to be sold, and classification of marketable securities)
- Application of new accounting pronouncements
- Accounting measurements that involve complex processes
- Events or transactions that involve significant measurement uncertainty, including accounting estimates, ***and related disclosures***
- ***Omitting, or obscuring, significant information in disclosures***
- Pending litigation and contingent liabilities (for example, sales warranties, financial guarantees, and environmental remediation)

AU-C Section 320, *Materiality in Planning and Performing an Audit*

Introduction

[No amendments to paragraphs .01–.05.]

Materiality in the Context of an Audit

.06 In planning the audit, the auditor makes judgments about ~~the size of~~ misstatements that will be considered material. These judgments provide a basis for

- a. determining the nature and extent of risk assessment procedures;
- b. identifying and assessing the risks of material misstatement; and
- c. determining the nature, timing, and extent of further audit procedures.

The materiality determined when planning the audit does not necessarily establish an amount below which uncorrected misstatements, individually or in the aggregate, will always be evaluated as immaterial. The circumstances related to some misstatements may cause the auditor to evaluate them as material even if they are below materiality. ~~Although it~~ ^{is} not practicable to design audit procedures to detect *all* misstatements that could be material solely because of their nature (that is, qualitative considerations). ***However, consideration of the nature of potential misstatements in disclosures is relevant to the design of audit procedures to address risks of material misstatement.¹ In addition, when evaluating the effect on the financial statements of all uncorrected misstatements,*** the auditor considers not only the size but also the nature of uncorrected misstatements, and the particular circumstances of their occurrence, ~~when evaluating their effect on the financial statements.~~ ^{fn+ 2} ***(Ref: par. .A1)***

¹ See paragraphs .A141–.A142 of section 315, **Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement.**

^{fn+ 2} [Footnote omitted for purposes of this ~~proposed~~ SAS.]

[Footnote 2 is renumbered as footnote 3.]

[No amendments to paragraphs .07–.14.]

Application and Other Explanatory Material

Materiality in the Context of an Audit (Ref: par. .06)

.A1 Identifying and assessing the risks of material misstatement⁴ involves the use of professional judgment to identify those classes of transactions, account balances, and disclosures, including qualitative disclosures, the misstatement of which could be material (in general, misstatements are considered to be material if they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements as a whole). When considering whether misstatements in qualitative disclosures could be material, the auditor may identify relevant factors such as the following:

- *The circumstances of the entity for the period (for example, the entity may have undertaken a significant business combination during the period)*
- *The applicable financial reporting framework, including changes therein (for example, a new financial reporting standard may require new qualitative disclosures that are significant to the entity)*
- *Qualitative disclosures that are important to users of the financial statements because of the nature of an entity (for example, liquidity risk disclosures may be important to users of the financial statements for a financial institution)*

⁴ *Paragraph .25 of section 315 requires the auditor to identify and assess the risk of material misstatement at the financial statement and assertion level.*

[All subsequent footnotes are renumbered.]

[Paragraphs .A1–.A11 are renumbered as .A2–.A12. The content is unchanged.]

Determining Materiality and Performance Materiality When Planning the Audit

Materiality Level or Levels for Particular Classes of Transactions, Account Balances, or Disclosures (Ref: par. .10)

~~A12~~.A13 Factors that may indicate the existence of one or more particular classes of transactions, account balances, or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements include the following:

- Whether law, regulation, or the applicable financial reporting framework affect users' expectations regarding the measurement or disclosure of certain items (for example, related party transactions, ~~and~~ the remuneration of management and those charged with governance, *and sensitivity analysis for fair value accounting estimates with high estimation uncertainty*)
- The key disclosures with regard to the industry in which the entity operates (for example, research and development costs for a pharmaceutical company)
- Whether attention is focused on a particular aspect of the entity's business that is separately disclosed in the financial statements (for example, ~~a newly acquired business~~ *disclosures about discontinued operations or a significant business combination*)

[Paragraphs .A13–.A16 are renumbered as paragraphs .A14–.A17. The content is unchanged.]

AU-C Section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*

[No amendments to paragraphs .01–.20.]

Substantive Procedures Related to the Financial Statement Closing Process

.21 The auditor’s substantive procedures should include audit procedures related to the financial statement closing process, such as

- a. agreeing or reconciling ***information in*** the financial statements with the underlying accounting records, ***including agreeing or reconciling information in disclosures, whether such information is obtained from within or outside of the general and subsidiary ledgers*** and
- b. examining material journal entries and other adjustments made during the course of preparing the financial statements. (Ref: par. .A57)

[No amendments to paragraphs .22–.25.]

Adequacy of Presentation and Disclosure *of the Financial Statements*

26. The auditor should perform audit procedures to evaluate whether the overall presentation of the financial statements, ~~including the related disclosures,~~ is in accordance with the applicable financial reporting framework. ***In making this evaluation, the auditor should consider whether the financial statements are presented in a manner that reflects the following:***

- a. ***The appropriate classification and description of financial information and the underlying transactions, events and conditions***
- b. ***The appropriate presentation, structure and content of the financial statements (Ref: par. .A72)***

[No amendments to paragraphs .27–.32.]

Documentation

33. The auditor’s documentation should demonstrate that ***information in*** the financial statements agrees or reconciles with the underlying accounting records, ***including agreeing or reconciling disclosures, whether such information is obtained from within or outside of the general and subsidiary ledgers.***

[No amendments to paragraphs .A1–.A13.]

Responding to the Assessed Risks at the Assertion Level (Ref: par. .07a)

.A14 In addition, certain audit procedures can be performed only at or after the period-end. For example

- agreeing *or reconciling information in* the financial statements, *including classes of transactions, account balances and disclosures, with the underlying* ~~to the~~ accounting records *including, as applicable, those relevant accounting records that are outside the general and subsidiary ledgers*;
- examining adjustments made during the course of preparing the financial statements, and
- procedures to respond to a risk that at the period-end the entity may have entered into improper sales contracts or transactions may not have been finalized.

.A15 Further relevant factors that influence the auditor’s consideration of when to perform audit procedures include

- the effectiveness of the control environment.
- when relevant information is available (for example, electronic files may subsequently be overwritten, or procedures to be observed may occur only at certain times).
- the nature of the risk (for example, if there is a risk of inflated revenues to meet earnings expectations by subsequent creation of false sales agreements, the auditor may examine contracts available on the date of the period-end).
- the period or date to which the audit evidence relates.
- *the timing of the preparation of the financial statements, particularly for those disclosures that provide further explanation about amounts recorded in the financial statements.*

[No amendments to paragraphs .A16–.A56.]

Substantive Procedures Related to the Financial Statement Closing Process (Ref: par. .21b)

.A57 The nature and also the extent of the auditor’s *substantive procedures related to the financial statement closing process, including* testing the appropriateness of journal entries and other adjustments, depends on the nature and complexity of the entity’s financial reporting process and the related risks of material misstatement.

[No amendments to paragraphs .A58–.A71.]

Adequacy of Presentation and Disclosure of the Financial Statements (Ref: par. .26)

.A72 Evaluating the overall **appropriate** presentation, **structure, and content** of the financial statements, including the related disclosures, relates to whether the individual financial statements are presented in a manner that reflects the appropriate classification and description of financial information, and the form, arrangement, and content of the financial statements and their appended notes. This includes, for example, **consideration of** the terminology used **as required by the applicable financial reporting framework**, the amount **level** of detail given **provided, the** classification of items in the statements, **aggregation and disaggregation of amounts**, and the bases of amounts set forth.

[No amendments to paragraphs .A73–.A76.]

AU-C Section 450, *Evaluation of Misstatements Identified During the Audit*

[No amendments to paragraphs .01–.04.]

Definitions

.04 For purposes of generally accepted auditing standards, the following terms have the meanings attributed as follows:

Misstatement. A difference between the *reported* amount, classification, presentation, or disclosure of a ~~reported~~ financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be presented fairly in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud. Misstatements also include those adjustments of amounts, classifications, presentations, or disclosures that, in the auditor’s professional judgment, are necessary for the financial statements to be presented fairly, in all material respects. (Ref: par. .A1)

...

[No amendments to paragraphs .05–.12.]

Misstatement (Ref: par. .04)

.A1 Misstatements may result from fraud or error, such as

- a. an inaccuracy in gathering or processing data from which the financial statements are prepared;
- b. an omission of an amount or disclosure, *including inadequate or incomplete disclosures and omission of those disclosures required to meet disclosure objectives of certain financial reporting frameworks as applicable*;
- c. a financial statement disclosure that is not presented in accordance with the applicable financial reporting framework;
- d. an incorrect accounting estimate arising from overlooking, or clear misinterpretation of, facts; ~~and~~
- e. judgments of management concerning accounting estimates that the auditor considers unreasonable or the selection or application of accounting policies that the auditor considers inappropriate;
- f. *an inappropriate classification, aggregation, or disaggregation of information; and*

g. the omission of a disclosure necessary for the financial statements to achieve fair presentation beyond disclosures specifically required by the framework.

Other examples of misstatements arising from fraud are provided in section 240, *Consideration of Fraud in a Financial Statement Audit*.⁵

⁵ [Footnote omitted for purposes of this ~~proposed~~-SAS.]

Accumulation of Identified Misstatements (Ref: par. .05)

“Clearly Trivial”

.A2 ~~The auditor may designate an amount below which misstatements would be clearly trivial and would not need to be accumulated because the auditor expects that the accumulation of such amounts clearly would not have a material effect on the financial statements. **Paragraph .05 requires the auditor to accumulate misstatements identified during the audit other than those that are clearly trivial.** “Clearly trivial” is not another expression for “not material.” Matters **Misstatements** that are clearly trivial will be of a wholly different (smaller) order of magnitude, **or of a wholly different nature, than those that would be determined to be material** than materiality determined in accordance with section 320, and will be matters **and will be misstatements** that are clearly inconsequential, whether taken individually or in the aggregate and whether judged by any criteria of size, nature, or circumstances. When there is any uncertainty about whether one or more items are clearly trivial, the ~~matter~~ **misstatement** is considered not to be clearly trivial.~~

Misstatements in Individual Statements

.A3 ~~The auditor may designate an amount below which misstatements of amounts in the individual statements would be clearly trivial and would not need to be accumulated because the auditor expects that the accumulation of such amounts clearly would not have a material effect on the financial statements. However, misstatements of amounts that are above the designated amount would be accumulated as required by paragraph .05. In addition, misstatements relating to amounts may not be clearly trivial based on their nature or circumstances and, if not clearly trivial, would be accumulated as required by paragraph .05 of this section.~~

Misstatements in Disclosures

.A4 ~~Misstatements in disclosures may also be clearly trivial whether taken individually or in the aggregate and whether judged based on size, nature, or circumstances. Misstatements in disclosures that are not clearly trivial are also accumulated to assist the auditor in evaluating the effect of such misstatements on the relevant disclosures and the financial statements as a whole. Paragraph .A23 provides examples of when misstatements in qualitative disclosures may be material.~~

Accumulation of Misstatements

.A5 ~~Misstatements by nature or circumstances, accumulated as described in paragraphs .A3–.A4, cannot be added together as is possible in the case of misstatements of amounts. Nevertheless, the auditor is required by paragraph .11 to evaluate those misstatements individually and in the aggregate (that is, collectively with other misstatements) to determine whether they are material.~~

~~.A3A6~~ To assist the auditor in evaluating the effect of misstatements accumulated during the audit and in communicating misstatements to management and those charged with governance, it may be useful to distinguish between factual misstatements, judgmental misstatements, and projected misstatements, described as follows:

- *Factual misstatements* are misstatements about which there is no doubt.
- *Judgmental misstatements* are differences arising from the judgments of management **including those concerning recognition, measurement, presentation, and disclosure in the financial statements (including accounting estimates that the auditor considers unreasonable, or the selection or application of accounting policies)** that the auditor considers **unreasonable or** inappropriate.
- *Projected misstatements* are the auditor's best estimate of misstatements in populations, involving the projection of misstatements identified in audit samples to the entire population from which the samples were drawn. Guidance on the determination of projected misstatements and evaluation of the results is set out in section 530, *Audit Sampling*.

[Paragraphs .A4–.A5 are renumbered .A7–.A8. The content is unchanged.]

Communication and Correction of Misstatements (Ref: par. .07–.09)

~~.A6.A9~~ Timely communication of misstatements to the appropriate level of management is important because it enables management to evaluate whether the items **classes of transactions, account balances, and disclosures** are misstatements, inform the auditor if it disagrees, and take action as necessary. Ordinarily, the appropriate level of management is the one that has responsibility and authority to evaluate the misstatements and to take the necessary action.

[Paragraphs .A7–.A18 are renumbered as .A10–.A21. The content is unchanged.]

Evaluating the Effect of Uncorrected Misstatements (Ref: par. .10–.11)

~~.A19.A22~~ Each individual misstatement **of an amount** is considered to evaluate its effect on the relevant classes of transactions, account balances, or disclosures, including whether the materiality level for that particular class of transactions, account balance, or disclosure, if any, has been exceeded.

.A23 *In addition, each individual misstatement of a qualitative disclosure is considered to evaluate its effect on the relevant disclosures, as well as its overall effect on the financial statements as a whole. The determination of whether a misstatement in a qualitative disclosure is material, in the context of the applicable financial reporting framework and the specific circumstances of the entity, is a matter that involves the exercise of professional judgment. Examples of misstatements that may be material include the following:*

- *Inaccurate or incomplete descriptions of information about the objectives, policies, and processes for managing capital*
- *The omission of information about the events or circumstances that have led to an impairment loss (for example, a significant long-term decline in the demand for a metal or commodity)*
- *An incorrect description of an accounting policy relating to a significant item in any of the statements that the financial statements comprise*
- *An inadequate description of the sensitivity of an exchange rate*

.A24 In determining whether uncorrected misstatements by nature are material as required by paragraph .11, the auditor considers uncorrected misstatements in amounts and disclosures. Such misstatements may be considered material either individually or in combination with other misstatements. For example, depending on the misstatements identified in disclosures, the auditor may consider the following:

- *Whether identified errors are recurring or pervasive*
- *Whether a number of identified misstatements are relevant to the same matter, and considered collectively may affect the users' understanding of that matter*

This consideration of accumulated misstatements is also helpful when evaluating the financial statements as discussed in paragraph Error! Reference source not found. of ~~proposed~~ SAS Forming an Opinion and Reporting on Financial Statements,¹⁶ or paragraph A69 of SAS Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA, which states that evaluating whether the financial statements achieve fair presentation may include discussions with management about whether the presentation of amounts and disclosures obscures useful information, or results in misleading information.

¹⁶ Paragraph .16d of section 700, Forming an Opinion and Reporting on Financial Statements.

[Footnote 16 is renumbered as footnote 17.]

[Paragraphs .A20–.A23 are renumbered as .A25–.A28. The content is unchanged.]

~~.A24~~^{A29} Section 240 explains how the implications of a misstatement that is, or may be, the result of fraud are required to be considered with regard to other aspects of the audit, even if the size of the misstatement is not material in relation to the financial statements. ^{fn-17} ¹⁸ *Depending on the circumstances, misstatements in disclosures could also be indicative of fraud and, for example, may arise from the following:*

- *Misleading disclosures that have resulted from bias in management's judgments*
- *Extensive duplicative or uninformative disclosures that are intended to obscure a proper understanding of matters in the financial statements*

When considering the implications of misstatements in classes of transactions, account balances, and disclosures, the auditor exercises professional skepticism in accordance with section 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards.¹⁹

¹⁹ Paragraph .17 of AU-C section 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards.

[All subsequent footnotes are renumbered.]

[Paragraphs .A25–.A28 are renumbered as .A30–.A33. The content is unchanged.]

AU-C Section 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements*

[No amendments to paragraphs .01–.A17.]

Audit Conclusions and Reporting

Opening Balances (Ref: par. .15)

.A18 If the auditor encountered significant difficulty in obtaining sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period’s financial statements, the auditor may determine this to be a key audit matter in accordance with ~~proposed~~-SAS Communicating Key Audit Matters in the Independent Auditor’s Report.

[Paragraph .A18 is renumbered as paragraph .A19. The content is unchanged.]

Exhibit A—Illustration of Report With Disclaimer of Opinion on Results of Operations and Cash Flows and Unmodified Opinion on Financial Statements

Note: 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.

~~.A19~~.A20 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 section 210, Terms of Engagement.*
- The auditor did not observe the counting of the physical inventory at the beginning of the current period and was unable to obtain sufficient appropriate audit evidence regarding the opening balances of inventory.

- The possible effects of the inability to obtain sufficient appropriate audit evidence regarding opening balances of inventory are deemed to be material and pervasive to the entity's results of operations and cash flows.¹
- The financial position at year-end is fairly presented.
- A disclaimer of opinion regarding the results of operations and cash flows and an unmodified opinion regarding financial position is considered appropriate in the circumstances.
- ***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 section 570, The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern. ~~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.***

¹ [Footnote omitted for purposes of this ~~proposed~~-SAS.]

Independent Auditor's Report

[Appropriate Addressee]

[City and State]

Report on the *Audit of the* Financial Statements²

Opinions

We have audited the ~~accompanying~~ balance sheet of ABC Company as of December 31, 20X1, and were engaged to audit 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.

Disclaimer of Opinion on the Results of Operations and Cash Flows

We do not express an opinion on the results of operations and cash flows of ABC Company for the year ended December 31, 20X1. Because of the significance of the matter described in the Basis for Disclaimer of Opinion on the Results of Operations and Cash Flows ***section of our report*** ~~paragraph~~, however, we ***have not been*** ~~were not~~ able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the results of operations and cash flows for the year ended December 31, 20X1. Accordingly, we do not express an opinion on the results of operations and cash flows for the year ended December 31, 20X1.

Opinion on the Financial Position

In our opinion, the balance sheet presents fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinions

We were not engaged as auditors of the Company until after December 31, 20X0, and, therefore, did not observe the counting of physical inventories at the beginning of the year. We were unable to satisfy ourselves by performing other auditing procedures concerning the inventory held at December 31, 20X0. Since opening inventories enter into the determination of net income and cash flows, we were unable to determine whether any adjustments might have been necessary in respect of the profit for the year reported in the income statement and the net cash flows from operating activities reported in the cash flow statement.

²The 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 conducted our audit of the balance sheet in accordance with auditing standards generally accepted in the United States of America. ***Our responsibilities under those standards are further described in the***

Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Company, and to meet ~~have fulfilled~~ our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the balance sheet is free from material misstatement.

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

Responsibilities of Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America, **and for ~~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 ~~Responsibility~~ ***Responsibilities for the Audit of the Financial Statements***

Our responsibility is to **conduct an audit of the Company's** ~~express an opinion on these~~ financial statements based on conducting the audit in accordance with auditing standards generally accepted in the United States of America. **However, b**Because of the matters described in the **Basis for Opinions section of our report**, ~~paragraph, however,~~ we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the results of operations and cash flows.

~~An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.^{fn-3} Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.~~

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

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 generally accepted auditing standards 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 taken 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 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.³ Accordingly, no such opinion is expressed.*
- *Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as the overall presentation of the consolidated financial statements.*
- *Conclude 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 for a reasonable period of time. ~~within one year after the date that the financial statements are issued.~~*

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.

³ *In circumstances in which the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, the auditor should omit the following: "but not for the purpose of expressing an opinion on the effectiveness of [the entity's] internal control. Accordingly, no such opinion is expressed."*

Report on Other Legal and Regulatory Requirements

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

[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.]

~~[Auditor's signature]~~ 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]

[No further amendments to AU-C section 510.]

AU-C Section 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures

[No amendments to paragraphs .01–.A17.]

Obtaining an Understanding of How Management Identifies the Need for Accounting Estimates (Ref: par. .08b)

.A18 Inquiries of management about changes in circumstances may include, for example, inquiries about whether

- the entity has engaged in new types of transactions that may give rise to accounting estimates.
- terms of transactions that gave rise to accounting estimates have changed.
- accounting policies relating to accounting estimates have changed as a result of changes to ***within*** the requirements of the applicable financial reporting framework or otherwise.
- regulatory or other changes outside the control of management have occurred that may require management to revise, or make new, accounting estimates.
- new conditions or events have occurred that may give rise to the need for new or revised accounting estimates.

[No amendments to paragraphs .A19–.A119. Paragraph .A119 included for context only.]

Recognition and Measurement Criteria

Recognition of the Accounting Estimates in the Financial Statements (Ref. par. 17a)

.A119 When management has recognized an accounting estimate in the financial statements, the focus of the auditor's evaluation is on whether the measurement of the accounting estimate is sufficiently reliable to meet the recognition criteria of the applicable financial reporting framework.

.A120 With respect to accounting estimates that have not been recognized, the focus of the auditor's evaluation is on whether the recognition criteria of the applicable financial reporting framework have, in fact, been met. Even when an accounting estimate has not been recognized and the auditor concludes that this treatment is appropriate, there may be a need for disclosure of the circumstances in the notes to the financial statements. ***When applicable, the auditor may also determine that an accounting estimate that has been identified as having a high estimation uncertainty there is a need to draw the reader's attention to a significant uncertainty is a key audit matter to be communicated in the auditor's report in accordance with proposed SAS Communicating Key Audit Matters in the Independent Auditor's Report, or the auditor may consider it necessary to include by adding an emphasis-of-matter paragraph to in the auditor's report (see proposed SAS Section Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report), addresses the use of such paragraphs. If the matter is determined to be a key audit matter, proposed SAS Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report prohibits the auditor from including that matter in an emphasis-of-matter paragraph in the auditor's report.***

[No further amendments to AU-C section 540.]

AU-C Section 600, Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)

[No amendments to paragraphs .01–.A96.]

EXHIBIT A—ILLUSTRATIONS OF AUDITOR'S REPORTS ON GROUP FINANCIAL STATEMENTS

.A97

Illustration 1—A Report With a Qualified Opinion When the Group Engagement Team Is Not Able to Obtain Sufficient Appropriate Audit Evidence on Which to Base the Group Audit Opinion (Ref: par. .A27)

Illustration 2—A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With Generally Accepted Auditing Standards (Ref: par. .A60)

Illustration 3—A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using a Different Financial Reporting Framework Than That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With GAAS (Ref: par. .A60)

Illustration 4—A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With Auditing Standards Other Than GAAS (Ref: par. .A60)

Note: 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—A Report With a Qualified Opinion When the Group Engagement Team Is Not Able to Obtain Sufficient Appropriate Audit Evidence on Which to Base the Group Audit Opinion

Circumstances include the following:

- *Audit of a complete set of general purpose financial statements (comparative).*
- *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 group engagement team is unable to obtain sufficient appropriate audit evidence relating to a significant component accounted for by the equity method because the group engagement team was unable to obtain the audited financial statements of the component as of December 31, 20X1 and 20X0, including the auditor's report thereon. In this example, the auditor of the group financial statements is not making reference to the report of a component auditor. In the auditor's professional judgment, the effect on the group financial statements of this inability to obtain sufficient appropriate audit evidence is material but not pervasive. 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 qualified opinion on the consolidated financial statements also affects the other information included in the annual report.⁷*
- *The auditor has not been engaged to communicate key audit matters.*

⁷ See footnote 1.

Independent Auditor's Report

*[Appropriate Addressee]
[City and State]*

Report on the Audit of the Consolidated Financial Statements¹

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.*

Qualified Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated 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 possible effects of the matter described in the Basis for Qualified Opinion section of our report, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Qualified Opinion

We were unable to obtain audited financial statements supporting the Company's investment in a foreign affiliate stated at \$_____ and \$_____ at December 31, 20X1 and 20X0, respectively, or its equity in earnings of that affiliate of \$_____ and \$_____, which is included in net income for the years then ended as described in Note X to the consolidated financial statements; nor were we able to satisfy ourselves as to the carrying value of the investment in the foreign affiliate or the equity in its earnings by other auditing procedures.

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 Consolidated Financial Statements section of our report. We are required to be independent of ABC Company, and to meet have fulfilled 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.

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 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 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 risk. 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 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 for a reasonable period of time. ~~within one year after the date the financial statements are issued.~~*

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.

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.”

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.]⁸

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 1 — A Report With a Qualified Opinion When the Group Engagement Team Is Not Able to Obtain Sufficient Appropriate Audit Evidence on Which to Base the Group Audit Opinion

~~In this example, the group engagement team is unable to obtain sufficient appropriate audit evidence relating to a significant component accounted for by the equity method because the group engagement team was unable to obtain the audited financial statements of the component as of December 31, 20X1 and 20X0, including the auditor’s report thereon. In this example, the auditor of the group financial statements is not making reference to the report of a component auditor.~~

~~In the auditor’s professional judgment, the effect on the group financial statements of this inability to obtain sufficient appropriate audit evidence is material but not pervasive. If, in the auditor’s professional judgment, the effect on the group financial statements of the inability to obtain sufficient appropriate audit~~

⁸ See footnote 1.

evidence is material and pervasive, the auditor would disclaim an opinion, in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Consolidated Financial Statements^{fn1}

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

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

~~An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.^{fn2} Accordingly, we express no such opinion.~~

^{fn1} The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

^{fn2} In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, this sentence would be worded as follows: "In making those risk

~~An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.~~

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

Basis for Qualified Opinion

~~We were unable to obtain audited financial statements supporting the Company's investment in a foreign affiliate stated at \$_____ and \$_____ at December 31, 20X1 and 20X0, respectively, or its equity in earnings of that affiliate of \$_____ and \$_____, which is included in net income for the years then ended as described in Note X to the consolidated financial statements; nor were we able to satisfy ourselves as to the carrying value of the investment in the foreign affiliate or the equity in its earnings by other auditing procedures.~~

Qualified Opinion

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

Report on Other Legal and Regulatory Requirements

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

[Auditor's signature]

[Auditor's city and state]

[Date of the auditor's report]

Illustration 2—A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With Generally Accepted Auditing Standards

assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances." In addition, the next sentence, "Accordingly, we express no such opinion." would not be included.

Circumstances include the following:

- *Audit of a complete set of general purpose financial statements (comparative).*
- *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 of the group financial statements is making reference to the audit of the financial statements of a component prepared using the same financial reporting framework as that used for the group financial statements and performed by a component auditor in accordance with generally accepted auditing standards (GAAS).*
- *The auditor has concluded that an unmodified (that is, “clean”) opinion is appropriate based on the audit evidence obtained.*
- *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.⁹*
- *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 Consolidated Financial Statements¹

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.

Opinion

⁹ See footnote 1.

We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated 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, based on our audits and the report of the other auditors, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We did not audit the financial statements of B Company, a wholly owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of the other auditors.

Basis for Opinion

~~*We did not audit the financial statements of B Company, a wholly owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of the other auditors.*~~

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 Consolidated Financial Statements section of our report. We are required to be independent of ABC Company, and to meet have fulfilled 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.

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 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 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 consolidated 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.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 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 for a reasonable period of time. ~~within one year after the date that the financial statements are issued.~~*

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.

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."*

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 2 — A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With Generally Accepted Auditing Standards~~

~~In this example, the auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using the same financial reporting framework as that used for the group financial statements and performed by a component auditor in accordance with generally accepted auditing standards (GAAS).~~

Independent Auditor's Report

[Appropriate Addressee]

Report on the Consolidated Financial Statements^{fn1}

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

Management's Responsibility for the Financial Statements

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

^{fn1} The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

Auditor's Responsibility

~~Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of B Company, a wholly owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.~~

~~An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.^{fn2} Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.~~

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

Opinion

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

Report on Other Legal and Regulatory Requirements

^{fn2}~~In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances." In addition, the next sentence, "Accordingly, we express no such opinion." would not be included.~~

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

~~[Auditor's signature]~~

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

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

Illustration 3—A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using a Different Financial Reporting Framework From That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With GAAS

Circumstances are the same as in illustration 2, except in this example, the auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using a different financial reporting framework than that used for the group financial statements and performed by a component auditor in accordance with GAAS.

Independent Auditor's Report

[Appropriate Addressee]

[City and State]

Report on the Audit of the Consolidated Financial Statements¹

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.*

Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated 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, based on our audits and the report of the other auditors, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We did not audit the financial statements of B Company, a wholly owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements, which were prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, were audited by other auditors, whose report has been furnished to us. We have applied audit procedures on the conversion adjustments to the financial statements of B Company, which conform those financial statements to accounting principles generally accepted in the United States of America. Our opinion, insofar as it relates to the amounts included for B Company, prior to these conversion adjustments, is based solely on the report of the other auditors.

Basis for Opinion

~~We did not audit the financial statements of B Company, a wholly owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements, which were prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, were audited by other auditors, whose report has been furnished to us. We have applied audit procedures on the conversion adjustments to the financial statements of B Company, which conform those financial statements to accounting principles generally accepted in the United States of America. Our opinion, insofar as it relates to the amounts included for B Company, prior to these conversion adjustments, is based solely on the report of the other auditors.~~

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 Consolidated Financial Statements section of our report. We are required to be independent of ABC Company, and to meet ~~have fulfilled~~ 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.

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 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 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 consolidated 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.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 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 for a reasonable period of time. ~~within one year after the date that the financial statements are issued.~~*

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.

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."*

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 3—A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using a Different Financial Reporting Framework From That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With GAAS~~

~~In this example, the auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using a different financial reporting framework than that used for the group financial statements and performed by a component auditor in accordance with GAAS.~~

Independent Auditor's Report

[Appropriate Addressee]

Report on the Consolidated Financial Statements^{fn1}

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

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

^{fn1} ~~The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.~~

~~Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of B Company, a wholly owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements, which were prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, were audited by other auditors, whose report has been furnished to us. We have applied audit procedures on the conversion adjustments to the financial statements of B Company, which conform those financial statements to accounting principles generally accepted in the United States of America. Our opinion, insofar as it relates to the amounts included for B Company, prior to these conversion adjustments, is based solely on the report of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.~~

~~An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.^{fn2} Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.~~

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

Opinion

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

^{fn2} ~~In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances." In addition, the next sentence, "Accordingly, we express no such opinion." would not be included.~~

Report on Other Legal and Regulatory Requirements

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

[Auditor's signature]

[Auditor's city and state]

[Date of the auditor's report]

Illustration 4—A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With Auditing Standards Other Than GAAS

Circumstances are the same as in illustration 2, except in this example, the auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using the same financial reporting framework as that used for the group financial statements and performed by a component auditor in accordance with auditing standards other than GAAS or standards promulgated by the Public Company Accounting Oversight Board. The group engagement partner has determined that the component auditor performed additional audit procedures to meet the relevant requirements of GAAS. If additional procedures were not necessary for the audit of the component auditor to meet the relevant requirements of GAAS, illustration 2 is applicable.

Independent Auditor's Report

[Appropriate Addressee]

[City and State]

Report on the Audit of the Consolidated Financial Statements¹

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.*

Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated 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, based on our audits and the report of, and additional audit procedures performed by, the other auditors, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We did not audit the financial statements of B Company, a wholly owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements were audited by other auditors in accordance with [describe the set of auditing standards], whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of, and additional audit procedures to meet the relevant requirements of auditing standards generally accepted in the United States of America performed by, the other auditors.

Basis for Opinion

~~*We did not audit the financial statements of B Company, a wholly owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements were audited by other auditors in accordance with [describe the set of auditing standards], whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of, and additional audit procedures to meet the relevant requirements of auditing standards generally accepted in the United States of America performed by, the other auditors.*~~

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 Consolidated Financial Statements section of our report. We are required to be independent of ABC Company, and to meet ~~have fulfilled~~ 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.

Responsibilities of Management for the Consolidated Financial Statements

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

In preparing the 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 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 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 consolidated 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.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 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 for a reasonable period of time. ~~within one year after the date that the financial statements are issued.~~*

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.

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."*

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 4—A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With Auditing Standards Other Than GAAS~~

~~In this example, the auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using the same financial reporting framework as that used for the group financial statements and performed by a component auditor in accordance with auditing standards other than GAAS or standards promulgated by the Public Company Accounting Oversight Board. The group engagement partner has determined that the component auditor performed additional audit procedures to meet the relevant requirements of GAAS. If additional procedures were not necessary for the audit of the component auditor to meet the relevant requirements of GAAS, illustration 2 is applicable.~~

Independent Auditor's Report

[Appropriate Addressee]

Report on the Consolidated Financial Statements^{fn1}

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

Management's Responsibility for the Financial Statements

~~Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation~~

^{fn1} ~~The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.~~

and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of B Company, a wholly owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements were audited by other auditors in accordance with [*describe the set of auditing standards*], whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of, and additional audit procedures to meet the relevant requirements of auditing standards generally accepted in the United States of America performed by, the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.^{fn2} Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, based on our audits and the report of, and additional audit procedures performed by, the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and

^{fn2} In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances." In addition, the next sentence, "Accordingly, we express no such opinion." would not be included.

~~20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.~~

~~Report on Other Legal and Regulatory Requirements~~

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

~~[Auditor's signature]~~

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

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

[No further amendments to AU-C section 600.]

AU-C Section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*

[No amendments to paragraphs .01–.07.]

Definitions

.08 Reference to *financial statements* in this section means “a complete set of special purpose financial statements, including the related notes.”¹ ~~The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information.~~ The requirements of the applicable financial reporting framework determine the **presentation, structure, form** and content of the financial statements and what constitutes a complete set of financial statements.

¹[Footnote omitted for the purposes of this ~~proposed~~ SAS.]

[No further amendments to AU-C section 800.]

AU-C Section 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*

[No amendments to paragraphs .01–.05.]

Definitions

.06 For purposes of this section, reference to

a. an *element of a financial statement* or an *element* means an *element, account, or item of a financial statement*. (Ref: par. .A4)

b. a single financial statement or to a specific element of a financial statement includes the related **notes disclosures**. The related **notes disclosures** ordinarily comprise a summary of significant accounting policies and other explanatory **or other descriptive** information relevant to the financial statement or the specific element.

[No amendments to paragraphs .07–.24.]

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01)

.A1 Section 200 defines the term *historical financial information* as information expressed in financial terms regarding a particular entity, derived primarily from that entity’s accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past. It also defines the term *financial statements* as a structured representation of historical financial information, including ~~related notes~~ *disclosures*, intended to communicate an entity’s economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The term *financial statements* ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework, but can also refer to a single financial statement. ***Disclosures comprise explanatory or other descriptive information, set out as required, expressly permitted or otherwise allowed by the applicable financial reporting framework, on the face of a financial statement or in the notes.***⁶

⁶ Paragraph .14 of section 200.

[No further amendments to AU-C section 805.]

AU-C Section 806, Reporting Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements

[No amendments to paragraphs .01–.A7.]

.A8

Exhibit—Illustrations of Reports on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements (Ref: par. .12-.13)

[No amendments to illustrations 1-4]

Illustration 5 — A Report on Compliance With Aspects of Contractual Agreements Given in a Combined Report, and No Instances of Noncompliance Were Identified

Independent Auditor’s Report

[Appropriate Addressee]

[City and state]

Report on the Financial Statements¹⁰

Opinion

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

In our opinion, the 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 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.

Management's Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America, and for ~~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.

Auditor's Responsibilities for the Audit of the Financial Statements^y

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

¹⁰The subtitle "Report on the Financial Statements" is unnecessary in circumstances when the second subtitle "Report on Other Legal and Regulatory Requirements" is not applicable.

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 ~~An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the~~ audit ~~entity's preparation and fair presentation of the financial statements~~ in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.²⁴⁴ Accordingly, ~~we express~~ no such opinion is expressed.¹²
- ~~An audit also includes~~ Evaluate ~~evaluating~~ the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
- Conclude 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 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.

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

^{11,2} ~~In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances." In addition, the next sentence "Accordingly, we express no such opinion," would not be included.~~

¹² In circumstances in which the auditor also has a 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 the entity's internal control. Accordingly, no such opinion is expressed."

Opinion

~~In our opinion, the 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.~~

Other Matter

In connection with our audit, nothing came to our attention that caused us to believe that ABC Company failed to comply with the terms, covenants, provisions, or conditions of sections XX to YY, inclusive, of the Indenture dated July 21, 20X0 with XYZ Bank, insofar as they relate to accounting matters. However, our audit was not directed primarily toward obtaining knowledge of such noncompliance. Accordingly, had we performed additional procedures, ~~other~~ matters may have come to our attention regarding the Company's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the Indenture, insofar as they relate to accounting matters.

Restricted Use Relating to the Other Matter

The communication related to compliance with the aforementioned Indenture described in the Other Matter paragraph is intended solely for the information and use of the boards of directors and management of ABC Company and XYZ Bank and is not intended to be and should not be used by anyone other than these specified parties. ^{fn3}⁴³

Report on Other Legal and Regulatory Requirements

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

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

~~[Auditor's eCity and state where the auditor's report is issued]~~

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

AU-C Section 910, Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country

~~[No amendments to paragraphs .01–.A10.]~~

~~.A11—Illustrations of Auditor's Reports on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country (Ref: par. .A7)~~

Illustration 1 — U.S. Form of Independent Auditor's Report to Report on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country That Are Intended for Use Only Outside the United States

⁴³ ~~When the engagement is also performed in accordance with *Government Auditing Standards*, the alert may read as follows: "The purpose of the communication related to compliance with the aforementioned [*compliance requirements*] described in the Other Matter paragraph [*or, Report on Compliance*] is solely to describe the scope of our testing of compliance and the results of that testing. This communication is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering ABC Company's compliance. Accordingly, this communication is not suitable for any other purpose." The AICPA Audit Guide *Government Auditing Standards and Circular A-133 Audits* provides additional interpretative guidance, including illustrative reports.~~

Independent Auditor's Report

[Appropriate Addressee]

[City and state]

Opinion

We have audited the ~~accompanying~~ financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements, which, as described in note X to the financial statements, have been prepared on the basis of [*specify the financial reporting framework generally accepted*] in [*name of country*].

In our opinion, the 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 [specify the financial reporting framework generally accepted] in [name of country].

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (and [in name of country]). 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 to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit.

~~Management's Responsibility~~ Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of ~~these~~ these financial statements in accordance with [*specify the financial reporting framework generally accepted*] in [*name of country*], and for ; ~~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.

[Describe management's responsibilities for evaluating whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern, when the applicable financial reporting framework includes such a requirement¹⁴]

~~Auditor's Responsibility~~ Responsibilities for the Audit of the Financial Statements

¹⁴ Paragraph 32.b. of AU-C section 700, *Forming an Opinion and Reporting on Financial Statements*.

~~Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America (and [in name of country]).~~ Our objectives are Those standards require that we plan and perform the audit 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 generally accepted auditing standards 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* ~~An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the~~ audit ~~entity's preparation and fair presentation of the financial statements~~ in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, ~~we express~~ no such opinion is expressed.
- ~~An audit also includes evaluating~~ 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 the entity's ability to continue as a going concern for a reasonable period of time.*

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

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.

Opinion

~~In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with [specify the financial reporting framework generally accepted] in [name of country].~~

~~[Auditor's signature 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 — U.S. Form of Independent Auditor's Report To Report on Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country That Also Are Intended for Use in the United States

Independent Auditor's Report

[Appropriate Addressee]

[City and state]

Opinion

We have audited the ~~accompanying~~ financial statements of ABC Company, which comprise the balance sheet as of December 31, 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements, which, as described in note X to the financial statements, have been prepared on the basis of [*specify the financial reporting framework generally accepted*] in [*name of country*].

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (and [in name of country]). 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 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 Matter

As discussed in Note X to the financial statements, the Company prepares its financial statements in accordance with [specify the financial reporting framework generally accepted] in [name of country], which differ(s) from accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

~~Management's Responsibility~~ Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of ~~the~~ these financial statements in accordance with [specify the financial reporting framework generally accepted] in [name of country], and for ~~;~~ ~~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.

[Describe management's responsibilities for evaluating whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern, when the applicable financial reporting framework includes such a requirement¹⁵]

~~Auditor's Responsibility~~ Responsibilities for the Audit of the Financial Statements

~~Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America (and [in name of country]). Our objectives are~~ Those standards require that we plan and perform the audit 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 generally accepted auditing standards 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

¹⁵ Paragraph 32.b. of AU-C section 700, *Forming an Opinion and Reporting on Financial Statements*.

procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.

- *Obtain an understanding of* ~~An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the audit entity's preparation and fair presentation of the financial statements~~ in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, ~~we express~~ no such opinion is expressed.
- ~~An audit also includes evaluating~~ 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 the entity's ability to continue as a going concern 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.

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

Opinion

~~In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of ABC Company as of December 31, 20X1, and the results of its operations and its cash flows for the year then ended in accordance with [specify the financial reporting framework generally accepted] in [name of country].~~

Emphasis of Matter

~~As discussed in Note X to the financial statements, the Company prepares its financial statements in accordance with [specify the financial reporting framework generally accepted] in [name of country], which differ(s) from accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.~~

~~[Auditor's signature~~ 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]

Amendment to Statement on Auditing Standards No. 132, The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern

(*Boldface italics* denote new language. Deleted text is shown in ~~strikethrough~~.)

The amendment to each AU-C section is effective for audits of financial statements for periods ending on or after ~~June 15, 2019.~~ December 15, 2020. Early implementation is not permitted.

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

AU-C Section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*[†]

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

[No amendments to paragraphs .01–.23].

Use of the Going Concern Basis of Accounting Is Appropriate But Conditions and Events Have Been Identified

.24 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 should include ~~an emphasis-of-matter paragraph~~ ***a separate section*** in the auditor's report.⁶ ***with the heading "Substantial Doubt About the Entity's Ability to Continue as a Going Concern" that:*** (Ref: par. .A51–.A57A58)

- a. ***Draws attention to the note in the financial statements that discloses***
 - i. ***the conditions or events identified and management's plans that deal with these conditions or events; and***
 - ii. ***that these conditions or events indicate that substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time, and***
- b. ***States that the auditor's opinion is not modified with respect to the matter.***

⁶Paragraphs ~~.06–.07~~ of AU-C section 706, *Emphasis-of-Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report* (AICPA, *Professional Standards*), address requirements concerning ~~emphasis-of-matter paragraphs.~~

.25 ***The description in the going concern section*** about the entity's ability to continue as a going concern for a reasonable period of time should ~~be expressed through the use of~~ ***use*** terms consistent with those included in the applicable financial reporting framework. ~~In a going concern emphasis-of-matter paragraph,~~ ***The*** auditor should not use conditional language concerning the existence of substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time.

Adequate Disclosure About an Entity's Ability to Continue as a Going Concern Is Not Made in the Financial Statements

.26 If adequate disclosure about an entity's ability to continue as a going concern for a reasonable period of time is not made in the financial statements, the auditor should *do the following*:

a. Express a qualified opinion or adverse opinion, as appropriate, in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*

b. In the "*Basis for Qualified (Adverse) Opinion*" section of the auditor's report, state that

i. substantial doubt exists about the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter or

ii. substantial doubt about the entity's ability to continue as a going concern has been alleviated by management's plans but the financial statements do not adequately disclose this matter.

[No amendments to paragraphs .27–.28. Footnotes 7–38 are renumbered as 6–37.]

Comparative Presentations

.29 If substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time existed at the date of prior period financial statements that are presented on a comparative basis and that doubt has been removed in the current period, the going concern ~~emphasis-of-matter paragraph~~ *section* included in the auditor's report on the financial statements of the prior period should not be repeated. (Ref: par. ~~A59–A60~~ *A60–A61*)

Eliminating a "Going Concern" ~~Emphasis-of-Matter Paragraph~~ Section From a Reissued Report

.30 Management may request that the auditor reissue an auditor's report and eliminate a "~~Ggoing Ce~~concern" ~~emphasis-of-matter paragraph~~ *section* contained therein. Although an auditor has no obligation to reissue the report, if the auditor decides to reissue the report, the auditor should reassess the going concern status of the entity by doing the following:

- a.* Performing audit procedures related to the events or transactions that prompted the request to reissue the report without the "~~Ggoing Ce~~concern" ~~emphasis-of-matter paragraph~~ *section*
- b.* Performing the procedures listed in section 560, *Subsequent Events and Subsequently Discovered Facts*, at or near the date of reissuance, including procedures to evaluate the adequacy of the proposed disclosures regarding management's plans to mitigate the conditions or events that raised substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time^{8 7}
- c.* Considering the matters described in paragraphs .16–.18 of this section based on the conditions or circumstances at the date of reissuance
- d.* Considering the implications for the auditor's report in accordance with AU-C section 560^{9 8} (Ref: par. ~~A61–A62–A63~~)

^{8 7} Paragraphs .09–.11 of section 560, *Subsequent Events and Subsequently Discovered Facts*.

^{9 8} Paragraph .13 of section 560.

[No amendments to paragraphs .31–.A50.]

Use of the Going Concern Basis of Accounting Is Appropriate But Conditions and Events Have Been Identified (Ref. par. .24–.26)

Conditions and Events Have Been Identified and Substantial Doubt Has Not Been Alleviated

.A51 The identification of substantial doubt is a matter that is important to users' understanding of the financial statements. The use of a separate section with a heading that includes reference to the fact that substantial doubt exists about the entity's ability to continue as going concern alerts users to this circumstance.

.A52 The appendix to this section provides illustrations of the statements that are required to be included in the auditor's report on the financial statements (illustrations 1 and 2) and an illustration of the circumstances described in paragraph .A54 (illustration 3). Illustrations 1 and 3 provide examples in which FASB ASC is the applicable financial reporting framework. Illustration 2 provides an example in which the GASB statements are the applicable financial reporting framework. If an applicable financial reporting framework other than FASB ASC or the GASB statements is used, the wording in the illustrative reports in the appendix to this section may need to be adapted to reflect the application of the other financial reporting framework in the circumstances. The following is an illustration of a going concern emphasis of matter paragraph when (a) the auditor concludes substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time, (b) management's plans do not alleviate the substantial doubt, and (c) the entity is required under the applicable financial reporting framework to include a statement in the notes to the financial statements that substantial doubt exists.

Emphasis of Matter Regarding Going Concern

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations, has a net capital deficiency, and has stated that substantial doubt exists about the Company's ability to continue as a going concern. Management's evaluation of the events and conditions and management's plans regarding these matters are also described in Note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

~~.A53 The following is an illustration of a going concern emphasis of matter paragraph when (a) the auditor concludes that substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time, (b) management's plans do not alleviate the substantial doubt, and (c) the entity is not required under the applicable financial reporting framework to include a statement in the notes to the financial statements that substantial doubt exists.~~

Emphasis of Matter Regarding Going Concern

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency that raise substantial doubt about its ability to continue as a going concern. Management's evaluation of the events and conditions and management's plans regarding these matters are also described in Note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

.A51 .A53 When FASB ASC or the GASB statements are the applicable financial reporting framework used in the preparation of the financial statements, the auditor's conclusion about the entity's ability to continue as a going concern is expressed through the use of the phrase "substantial doubt about its (the entity's) ability to continue as a going concern." In other financial reporting frameworks, a similar term may be appropriate depending on the requirements of the applicable financial reporting framework. If the applicable financial

reporting framework does not include comparable terms, then wording that includes the terms *substantial doubt* and *going concern* may be appropriate.

Conditions and Events Have Been Identified and Substantial Doubt Has Been Alleviated

.A54 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 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 ~~proposed~~ SAS AU-C section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*, making reference to management's disclosures related to the conditions and events and management's plans related to those conditions and events.^{38 37} ***In this circumstance, the use of an emphasis-of-matter paragraph is to draw users' attention to the disclosures of the conditions and events and management's plans. It is distinguished from the situation in which the auditor concludes, after considering identified conditions or events and management's plans, that substantial doubt about the entity's ability to continue as a going concern remains, in which case the auditor is required by paragraph .24 of this section to include a separate "Going Concern" section in the auditor's report.***

³⁸³⁷ Paragraphs ~~.06-.078-9~~ of section 706 ~~proposed~~ SAS *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

~~.A55~~ The following is an illustration of an emphasis of matter paragraph when management has disclosed (a) conditions or events, considered in the aggregate, that raised substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time; (b) its evaluation of the significance of those conditions or events, considered in the aggregate, in relation to the entity's ability to meet its obligations; and (c) that the substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time has been alleviated by management's plans.

As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency. Management's evaluation of the events and conditions and management's plans to mitigate these matters are also described in Note X. Our opinion is not modified with respect to this matter.

As indicated in ~~proposed~~ SAS Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report, the use of an emphasis-of-matter paragraph is not appropriate if either of the following applies:

- a. ***The matter has been determined to be a key audit matter when ~~proposed~~ SAS Communicating Key Audit Matters in the Independent Auditor's Report applies.***
- b. ***The auditor would be required to modify the opinion in accordance with ~~proposed~~ SAS Modifications to the Opinion in the Independent Auditor's Report³⁸ as a result of the matter.***

³⁸ Paragraph 8 of ~~proposed~~ SAS *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*.

.A56 As indicated in ~~proposed~~ SAS Modifications to the Opinion in the Independent Auditor's Report, in circumstances in which conditions and events have been identified and the auditor concludes that, based on the audit evidence obtained, the disclosures are materially misstated, the auditor is required to modify the auditor's report.³⁹

³⁹ **Paragraph 7 of ~~proposed~~ SAS Modifications to the Opinion in the Independent Auditor's Report.**

Inappropriate Use of Conditional Language

~~A56~~ **.A57** Examples of conditional language that are inappropriate to use in the ~~emphasis-of-matter paragraph~~ **"Going Concern" section** include the following:

- a. If the Company continues to suffer recurring losses from operations and continues to have a net capital deficiency, there may be substantial doubt about its ability to continue as a going concern.
- b. The Company has been unable to renegotiate its expiring credit agreements. Unless the Company is able to obtain financial support, there is substantial doubt about its ability to continue as a going concern.

[Paragraphs .A57–.A60 are renumbered as .A58–.A61. The content is unchanged.]

Eliminating a Going Concern ~~Emphasis-of-Matter Paragraph~~ Section From a Reissued Report (Ref: par. .30)

~~.A61~~ **.A62** After the auditor has issued the auditor's report containing a **"Going Ceoncern" ~~emphasis-of-matter paragraph~~ section**, the auditor may be asked to reissue the auditor's report on the financial statements and eliminate the **"Ggoing Ceoncern" ~~emphasis-of-matter paragraph~~ section** that appeared in the original report. Such requests may occur after the conditions or events that gave rise to substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time have been resolved. For example, subsequent to the date of the auditor's original report, an entity might obtain needed financing.

[Paragraphs .A62–.A63 are renumbered as .A63–.A64. Footnotes 39–40 are renumbered as 40–41. The content is unchanged.]

Appendix—Illustrations of Auditor’s Reports Relating to Going Concern (Ref: par. .A52–.A56)

Illustration 1—An Auditor’s Report Containing an Unmodified Opinion and Includes a Going Concern Section When Management Is Required Under the Applicable Financial Reporting Framework to Include a Statement In the Notes to the Financial Statements That Conditions or Events Have Been Identified and Substantial Doubt Exists and Disclosure In The Financial Statements Is Adequate

Illustration 2—An Auditor’s Report Containing an Unmodified Opinion and Includes a Going Concern Section When Management Is Not Required Under the Applicable Financial Reporting Framework to Include a Statement in the Notes to the Financial Statements That Conditions or Events Have Been Identified, Substantial Doubt Exists, and Disclosure in the Financial Statements is Adequate

Illustration 3—An Auditor’s Report Containing an Unmodified Opinion and Includes an Emphasis-of-Matter Paragraph Because Substantial Doubt Has Been Alleviated

Illustration 1—An Auditor’s Report Containing an Unmodified Opinion and Includes a Going Concern Section When Management Is Required Under the Applicable Financial Reporting Framework to Include a Statement In the Notes to the Financial Statements That Conditions or Events Have Been Identified and Substantial Doubt Exists and Disclosure In The Financial Statements Is Adequate

For purposes of this illustrative auditor’s report, the following circumstances are assumed:

- ***Audit of a complete set of financial statements prepared in accordance with FASB ASC.***
- ***The auditor has concluded that an unmodified opinion is appropriate based on the audit evidence obtained.***
- ***The auditor has concluded, after considering identified conditions or events and management’s plans, that substantial doubt remains and the disclosures of the conditions or events and management’s plans are adequate.***
- ***Management is required under the FASB ASC to include an explicit statement in the notes to the financial statements that conditions or events have been identified and substantial doubt exists.***

INDEPENDENT AUDITOR’S REPORT

To the Shareholders of ABC Company [or Other Appropriate Addressee]

Report on the Audit of the Financial Statements

The auditor’s report is presented in accordance with paragraphs 19–42 of the [proposed](#) SAS Forming an Opinion and Reporting on Financial Statements. For illustrative purposes, the Going Concern section is

presented immediately after the “Basis for Opinion of the Auditor’s Report” section.

Substantial Doubt About the Company’s Ability to Continue as a Going Concern

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations, has a net capital deficiency, and has stated that substantial doubt exists about the Company’s ability to continue as a going concern. Management’s evaluation of the events and conditions and management’s plans regarding these matters are also described in Note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

Illustration 2—An Auditor’s Report Containing an Unmodified Opinion and Includes a Going Concern Section When Management is Not Required Under the Applicable Financial Reporting Framework to Include a Statement in the Notes to the Financial Statements that Conditions or Events Have Been Identified and Substantial Doubt Exists and Disclosure in the Financial Statements is Adequate

For purposes of this illustrative auditor’s report, the following circumstances are assumed:

- *Audit of a complete set of financial statements prepared in accordance with the GASB statements.*
- *The auditor has concluded that an unmodified opinion is appropriate based on the audit evidence obtained.*
- *The auditor has concluded, after considering identified conditions or events and management’s plans, that substantial doubt remains and the disclosures of the conditions or events and management’s plans are adequate.*
- *Management is not required under the GASB statements to include an explicit statement in the notes to the financial statements that conditions or events have been identified and substantial doubt exists (as opposed to the explicit statement required under the FASB ASC).*

INDEPENDENT AUDITOR’S REPORT

To the City Council of X, State Y [or Other Appropriate Addressee]

Report on the Audit of the Financial Statements

*The auditor’s report is presented in accordance with paragraphs 19–42 of the **proposed**-SAS Forming an Opinion and Reporting on Financial Statements. For illustrative purposes, the Going Concern section is presented immediately after the “Basis for Opinion of the Auditor’s Report” section.*

Substantial Doubt About the City’s Ability to Continue as a Going Concern

The accompanying financial statements have been prepared assuming that the City of X, State Y will continue as a going concern. As discussed in Note X to the financial statements, the City has suffered

recurring losses from its governmental activities and has a fund balance deficit that raise substantial doubt about its ability to continue as a going concern. Our opinion is not modified with respect to this matter.

Illustration 3—An Auditor’s Report Containing an Unmodified Opinion and Includes an Emphasis-of-Matter Paragraph Because Substantial Doubt Has Been Alleviated (see .A52)

For purposes of the illustrative auditor’s report, the following circumstances are assumed:

- *Audit of a complete set of financial statements prepared in accordance with FASB ASC.*
- *Management has disclosed conditions or events, considered in the aggregate, that raised substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time.*
- *Management has disclosed its evaluation of the significance of those conditions or events, considered in the aggregate, in relation to the entity’s ability to meet its obligations.*
- *Management has disclosed that the substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time has been alleviated by management’s plans.*
- *The auditor has concluded that management’s disclosures are adequate.*

INDEPENDENT AUDITOR’S REPORT

To the Shareholders of ABC Company [or Other Appropriate Addressee]

Report on the Audit of the Financial Statements

The auditor’s report is presented in accordance with paragraph 9 of the ~~proposed~~ SAS Emphasis-of Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor’s Report.

Emphasis-of-Matter

As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency. Management’s evaluation of the events and conditions and management’s plans to mitigate these matters are also described in Note X. Our opinion is not modified with respect to this matter.

AU-C Section 940, An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements [placeholder]