AU-C Section 9700

Forming an Opinion and Reporting on Financial Statements: Auditing Interpretations of Section 700

1. Reporting on Financial StatementsPrepared on a Liquidation Basis of Accounting

.01 *Question* — An entity prepares its financial statements using the liquidation basis of accounting in accordance with FASB *Accounting Standards Codification* (ASC) 205, *Presentation of Financial Statements*, because the entity is either in liquidation or liquidation is imminent. Is the auditor permitted to issue an unmodified opinion on such financial statements?

.02 *Interpretation* — Yes. A liquidation basis of accounting is considered generally accepted accounting principles (GAAP) for entities in liquidation or for which liquidation is imminent. Therefore, the auditor is permitted to issue an unmodified opinion on such financial statements, provided that the liquidation basis of accounting has been properly applied and that adequate disclosures are made in the financial statements in accordance with FASB ASC 205-30.

.03 Typically, the financial statements of entities using the liquidation basis of accounting are presented along with financial statements of a period prior to adoption of a liquidation basis that were prepared on the going concern basis in accordance with GAAP. Section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*, requires the auditor to include an emphasis-of-matter paragraph when a matter that is appropriately presented or disclosed in the financial statements is of such importance, in the auditor's professional judgment, that it is fundamental to users' understanding of the financial statements. If the auditor determines an emphasis-of-matter paragraph is appropriate, the emphasis-of-matter paragraph would state that the entity has changed the basis of accounting used to determine the amounts at which assets and liabilities are carried from the going concern basis to a liquidation basis.

.04 Two examples of auditor's reports with such an emphasis-of-matter paragraph follow.

Example 1

Report on the Audit of Single-Year Financial Statements in Year of Adoption of Liquidation Basis

<u>Independent Auditor's Report</u>

[*Appropriate Addressee*]

Opinion

We have audited the financial statements of XYZ Company, which comprise the statement of net assets in liquidation as of December 31, 20X2, the related statement of changes in net assets in liquidation for the period from April 26, 20X2 to December 31, 20X2, and the statements of income, changes in stockholders' equity, and cash flows for the period from January 1, 20X2 to April 25, 20X2, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the net assets in liquidation of XYZ Company as of December 31, 20X2, the changes in its net assets in liquidation for the period from April 26, 20X2 to December 31, 20X2, and the results of its operations and its cash flows for the period from January 1, 20X2 to April 25, 20X2, 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 XYZ 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 stockholders of XYZ Company approved a plan of liquidation on April 25, 20X2, and the Company determined liquidation is imminent. As a result, the Company changed its basis of accounting on April 25, 20X2 from the going concern basis to a liquidation basis. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Statements

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

Auditor’s Responsibilities for the Audit of the Financial Statements

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

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such

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

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of XYZ Company's internal control.[1] 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 evaluate the overall presentation of the financial statements.

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 that we identified during the audit.

[*Signature of the auditor's firm*]

[*City and state where report is issued*]

[*Date of the auditor's report*]

Example 2

Report on the Audit of Comparative Financial Statements in Year of Adoption of Liquidation Basis

<u>Independent Auditor's Report</u>

[*Appropriate Addressee*]

Opinion

We have audited the financial statements of XYZ Company, which comprise the balance sheet as of December 31, 20X1, the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, the statements of income, changes in stockholders' equity, and cash flows for the period from January 1, 20X2 to April 25, 20X2, the statement of net assets in liquidation as of December 31, 20X2, the related statement of changes in net assets in liquidation for the period from April 26, 20X2 to December 31, 20X2, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of XYZ Company as of December 31, 20X1, the results of its operations and its cash flows for the year then ended and for the period from January 1, 20X2 to April 25, 20X2, its net assets in liquidation as of December 31, 20X2, and the changes in its net assets in liquidation for the period from April 26, 20X2 to December 31, 20X2, in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under

[1] 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 XYZ Company's internal control. Accordingly, no such opinion is expressed."

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 XYZ Company, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. 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 stockholders of XYZ Company approved a plan of liquidation on April 25, 20X2, and the Company determined liquidation is imminent. As a result, the Company changed its basis of accounting on April 25, 20X2 from the going concern basis to a liquidation basis. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Statements

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

Auditor's Responsibilities for the Audit of the Financial Statements

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

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of XYZ Company's internal control.[2] Accordingly, no such opinion is expressed.

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[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 XYZ Company's internal control. Accordingly, no such opinion is expressed."

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

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 that we identified during the audit.

[*Signature of the auditor's firm*]

[*City and state where report is issued*]

[*Date of the auditor's report*]

.05 The auditor may, in subsequent years, continue to include an emphasis-of-matter paragraph in the auditor's report to emphasize that the financial statements are presented on a liquidation basis of accounting.

[Issue Date: December 1984; Revised: June 1993; Revised: February 1997; Revised: October 2000; Revised: June 2009; Revised: October 2011, effective for audits of financial statements for periods ending on or after December 15, 2012; Revised: May 2014; Revised: September 2014; Revised: March 2020.]

2. Sustainability Financial StatementsUnder Federal Financial Accounting Standards — Auditor Reporting

.06 *Question* — The Federal Accounting Standards Advisory Board issued Statement of Federal Financial Accounting Standards (SFFAS) No. 36, *Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government*. SFFAS No. 36, as amended, requires that the statement of long-term fiscal projections be presented in the consolidated financial report of the U.S. government as a basic financial statement starting in fiscal year 2015. The focus of this standard is on forward-looking information intended to aid users in assessing whether future resources will likely be sufficient to sustain public services and to meet obligations as they come due. The statement of long-term fiscal projections presents the actuarial present value of the U.S. government's estimated future income to be received and future expenditures to be paid. The statement of long-term fiscal projections includes information drawn from the current statement of social insurance (SFFAS No. 17, *Accounting for Social Insurance*, as amended, a basic statement since fiscal year 2006) and statement of changes in social insurance amounts (SFFAS No. 37, *Social Insurance: Additional Requirements for Management's Discussion and Analysis and Basic Financial Statements*, a basic statement since fiscal year 2011). Collectively, the statement of long-term fiscal projections, the statement of social insurance, and the statement of changes in social insurance amounts are referred to herein as sustainability financial statements. May an auditor report on these basic financial statements in accordance with auditing standards generally accepted in the United States of America (GAAS)? If so, how would an auditor report on these statements?

.07 *Interpretation* — Yes, consistent with Statement of Position 04-1, *Auditing the Statement of Social Insurance* (AUD sec. 35), an auditor may report on the basic financial statements, which include the statements of social insurance, changes in social insurance amounts, and long-term fiscal projections, in accordance with GAAS. Section 700, *Forming an Opinion and Reporting* *on Financial Statements*, provides requirements and guidance on forming an opinion on the basic financial statements. An illustration of an auditor's report containing an unmodified opinion on the U.S. government-wide financial statements follows[3] (footnotes are provided for necessary adjustments when reporting on component financial statements containing sustainability financial statements):

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Audit of the Financial Statements

Opinions on the Financial Statements

We have audited the financial statements of *the U.S. government*,[4] which comprise the consolidated financial statements and the sustainability financial statements. The consolidated financial statements comprise the *consolidated balance sheets as of September 30, 20XX and 20YY, and the related consolidated statements of net cost, of operations and changes in net position, reconciliations of net operating cost and budget deficit, and changes in cash balance from budget and other activities*[5] for the years then ended, and the related notes to the consolidated financial statements.

The sustainability financial statements comprise the statements of social insurance as of [*dates — five years presented*], the statements of changes in social insurance amounts for the periods [*dates — two periods presented*]*, and the statements of long-term fiscal projections as of September 30, 20XX and 20YY*, and the related notes to the sustainability financial statements.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, *the financial position of the U.S. government as of September 30, 20XX and 20YY, and its net cost, operations, and changes in net position; reconciliations of net operating cost and budget deficit, and changes in cash balance from budget and other activities*[6] for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Also, in our opinion, the sustainability financial statements referred to above present fairly, in all material respects, the *U.S. government's social insurance information as of* [*dates — five years presented*], its changes in social insurance amounts for the periods [*dates — two periods presented*], *and the long-term fiscal projections as of September 30, 20XX and 20YY*, in accordance with accounting principles generally accepted in the United States of America.

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[3] The sustainability financial statements do not articulate with the consolidated financial statements. For that reason, the opinion on the sustainability financial statements ordinarily will not affect the opinion on the consolidated financial statements. For example, the opinion on the sustainability financial statements may be modified, whereas the opinion on the consolidated financial statements may be unmodified.

[4] Italicized text would be applicable only to reports on the consolidated financial statements of the U.S. government. Where appropriate, alternative text applicable to reports on component entity financial statements are provided in other footnotes.

[5] For reports on component entity financial statements, the financial statements would be tailored to the financial statements presented, for example "...the balance sheets as of September 30, 20XX and 20YY and the related statements of net cost, *(and)* changes in net position, *(and custodial activity),* and combined statements of budgetary resources...".

[6] For reports on component entity financial statements, this language would be tailored to the financial statements presented, for example "... the financial position of [*name of entity*] as of September 30, 20XX and 20YY, and its net cost, changes in net position, *(and)* and budgetary resources *(, and custodial activity)....*"

Basis for Opinions

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States [*include Office of Management and Budget (OMB) Bulletin No. and title, if applicable*]. 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 U.S. government, and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Responsibilities of Management for the Financial Statements

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

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives under GAAS and *Government Auditing Standards* 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 opinions. 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 and *Government Auditing Standards* [*include OMB Bulletin, if applicable*] 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 to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS and *Government Auditing Standards*, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the U.S. Government's internal control. Accordingly, no such opinion is expressed.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about U.S. Government's ability to continue as a going concern for a reasonable period of time.

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

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 that we identified during the audit.

Emphasis of Matter

As discussed in Note X to the financial statements, the sustainability financial statements are based on management's assumptions. These sustainability financial statements present the actuarial present value of the U.S. government's estimated future income to be received and future expenditures to be paid using a projection period sufficient to illustrate long-term sustainability. The sustainability financial statements are intended to aid users in assessing whether future resources will likely be sufficient to sustain public services and to meet obligations as they come due. The statements of social insurance and changes in social insurance amounts are based on income and benefit formulas in current law and assume that scheduled benefits will continue after any related trust funds are exhausted. *The statements of long-term fiscal projections are based on the continuation of current policy.* The sustainability financial statements are not forecasts or predictions. The sustainability financial statements are not intended to imply that current policy or law is sustainable. In preparing the sustainability financial statements, management considers and selects assumptions and data that it believes provide a reasonable basis to illustrate whether current policy or law is sustainable. Assumptions underlying such sustainability information do not consider changes in policy or all potential future events that could affect future income, future expenditures, and sustainability, for example, implementation of policy changes to avoid trust fund exhaustion *or unsustainable debt levels*. Because of the large number of factors that affect the sustainability financial statements and the fact that future events and circumstances cannot be estimated with certainty, even if current policy is continued, there will be differences between the estimates in the sustainability financial statements and the actual results, and those differences may be material. Our opinion is not modified with respect to this matter.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the information in the Management's Discussion and Analysis and Required Supplementary Information (RSI) be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Federal Accounting Standards Advisory Board, who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the RSI in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Management is responsible for the other information [*included in the annual report*]. The other information comprises the [*information included in the annual report*] but does not include the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information, and we do not express an opinion or any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and consider whether a material inconsistency exists between the other information and the financial statements, or the other information otherwise appears to be materially misstated. If, based on the work performed, we conclude that an uncorrected material misstatement of the other information exists, we are required to describe it in our report.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated [*date of report*] on our consideration of the *U.S. government's* internal control over financial reporting and our report dated [*report date*] on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the *U.S. government's* internal control over financial reporting and compliance.

[*Signature of the auditor's firm*]

[*City and state where report is issued*]

[*Date of the auditor's report*]

[Issue Date: October 2015; Revised: March 2020.]

3. Reporting on AuditsConducted in Accordance With Auditing Standards Generally Acceptedin the United States of America and International Standards on Auditing

[.08–.13] [Withdrawn March 2020 due to the issuance of SAS No. 134, as amended.]

Introduction

On June 1, 2017, the PCAOB adopted AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*.[7] The SEC approved AS 3101 and related amendments on October 23, 2017. AS 3101 retains the pass or fail opinion of the existing PCAOB auditor's report but makes significant changes to the existing PCAOB auditor's report, including the following:

- Requiring communication of critical audit matters (CAMs). Any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that

[7] All PCAOB auditing standards can be found in *PCAOB Standards and Related Rules*.

- — relates to accounts or disclosures that are material to the financial statements and
- — involved especially challenging, subjective, or complex auditor judgment

- Requiring disclosure of auditor tenure. The year in which the auditor began serving consecutively as the company's auditor
- Other improvements to the auditor's report. Clarification of the auditor's role and responsibilities, such as a statement regarding the requirement for the auditor to be independent with respect to the company, and making the auditor's report easier to read

Among the other revisions, AS 3101 specifies the form of the report, including requirements related to the order of presentation and section titles. All the changes, except those relating to CAMs, are effective for audits of fiscal years ending on or after December 15, 2017.[8]

As noted in PCAOB Release No. 2017-001, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards*,

> There are situations in which an auditor may be required by law or regulation, or voluntarily agrees, to perform an audit engagement in accordance with PCAOB standards for a company whose audit is not subject to PCAOB oversight.[112] For example, SEC rules permit audits under PCAOB standards in connection with offerings under Regulation A and Regulation Crowdfunding. In these situations, certain elements of the auditor's report required under the final standard, such as the use of "registered public accounting firm" in the title or the statement regarding independence requirements, may not apply.
>
> [112] *Under the Sarbanes-Oxley Act, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, the PCAOB oversees the audits of "issuers" and brokers and dealers reporting under Exchange Act Rule 17a-5. See Sarbanes-Oxley Act Section 101. An "issuer" under the Sarbanes-Oxley Act is an entity whose securities are registered under Section 12 of the Exchange Act, or that is required to file reports under Section 15(d) of the Exchange Act, or that files or has filed a Securities Act registration statement that has not yet become effective and that it has not withdrawn. See Sarbanes-Oxley Section 2(a).*

GAAS currently address the appropriate form of report when an auditor issues a report referencing both GAAS and the standards of the PCAOB. Section 700, *Forming an Opinion and Reporting on Financial Statements*,[9] states

> When conducting an audit of financial statements in accordance with the standards of the PCAOB and the audit is not within the jurisdiction of the PCAOB as defined by the Sarbanes-Oxley Act of 2002 (the Act), as amended, the auditor is required to also conduct the audit in accordance with GAAS. In such circumstances, when the auditor refers to the standards of the PCAOB in addition to GAAS in the auditor's report, the auditor should use the form

[8] PCAOB Release No. 2017-001, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards*, was issued June 1, 2017, and was approved by the SEC on October 23, 2017. Staff Guidance *Changes to the Auditor's Report Effective for Audits of Fiscal Years Ending on or After December 15, 2017* (PCAOB Staff Guidance, sec. 300.04) (updated as of December 28, 2017), was prepared by PCAOB staff to help firms when implementing changes to the auditor's report effective for audits of fiscal years ending on or after December 15, 2017.

[9] Paragraph .46 of section 700, *Forming an Opinion and Reporting on Financial Statements*.

of report required by the standards of the PCAOB, amended to state that the audit was also conducted in accordance with GAAS.

Interpretation No. 4, "Reporting on Audits Conducted in Accordance With Auditing Standards Generally Accepted in the United States of America and the Standards of the PCAOB" (par. .14–.21), provides guidance on how an auditor complies with section 700[10] in the context of the revised reporting standards adopted by the PCAOB and approved by the SEC. Because of the phased approach of the effective dates of AS 3101, Interpretation No. 4 does not address the changes relating to CAMs.

Interpretation No. 5, "Communicating Critical Audit Matters When Reporting on Audits Conducted in Accordance With Auditing Standards Generally Accepted in the United States of America and the Standards of the PCAOB" (par. .22–.26), provides guidance on how an auditor complies with section 700 in the context of the PCAOB reporting standards when the communication of CAMs is required.

Although Interpretation No. 4 and Interpretation No. 5 have been determined to be consistent with GAAS, the interpretations should not be construed to be interpretations of PCAOB standards. Moreover, Interpretation No. 4 and Interpretation No. 5 have not been approved or acted upon by the PCAOB.

4. Reporting on AuditsConducted in Accordance With Auditing Standards Generally Acceptedin the United States of America and the Standards of the PCAOB

.14 *Question* — Section 700[11] states, in part, that the auditor should use the form of report required by the standards of the PCAOB. Are there any elements of the auditor's report required by the standards of the PCAOB whose presentation may need to be revised in order to comply with the PCAOB reporting requirements?

.15 *Interpretation* — Yes. To appropriately apply the requirement in section 700[12] to follow the PCAOB form of the report, the auditor will need to evaluate the circumstances of the engagement and also may need to modify the report as described in the following paragraphs to avoid making an untrue statement.

.16 *Question* — Paragraph .06 of AS 3101 states that the auditor "must include the title, 'Report of Independent Registered Public Accounting Firm'" and the related description in the "Basis for Opinion" section of the report required by paragraph .09*g* of AS 3101. Is it appropriate for an auditor to revise the report by removing the references to "registered" if the firm is not registered with the PCAOB?

.17 *Interpretation* — Yes, removing the reference to "registered" from the title and from the "Basis for Opinion" section of the report is appropriate if the firm is not registered with the PCAOB. As noted in Staff Questions and Answers *Audits of Financial Statements of Non-Issuers Performed Pursuant to the Standards of the Public Company Accounting Oversight Board*,[13] dated June 30, 2004, a public accounting firm does not need to be registered with

[10] See footnote 9.

[11] See footnote 9.

[12] See footnote 9.

[13] PCAOB Staff Guidance, sec. 100.01.

the PCAOB to perform an audit of a nonissuer in accordance with PCAOB standards.

.18 *Question* — How should the auditor address the requirement in paragraph .09*g* of AS 3101 that notes that the auditor "is required to be independent with respect to the company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the SEC and the PCAOB"?

.19 *Interpretation* — Generally, GAAS do not require the auditor to be independent under SEC and PCAOB standards unless required by law or regulation. Therefore, it would be appropriate in those circumstances for the auditor to revise the statement in the report regarding independence to reflect the circumstances of the engagement. For example, if the auditor is not required to be independent under U.S. federal securities laws and the applicable rules and regulations of the SEC and the PCAOB, this statement may be amended to read, "We are required to be independent with respect to the Company in accordance with the relevant ethical requirements relating to our audit."[14] Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards,* explains that relevant ethical requirements consist of the AICPA Code of Professional Conduct together with rules of state boards of accountancy and applicable regulatory agencies that are more restrictive.[15] Relevant ethical requirements may exist in several different sources, such as ethical codes and additional rules and requirements within law and regulation. Depending on the circumstances, for example, when independence and ethical requirements are contained in a limited number of sources, the auditor may choose to name the relevant sources (such as the AICPA Code of Professional Conduct) or rule or applicable regulation or may refer to a term that appropriately describes those sources.

.20 In addition, the auditor may need to revise the reference to "the standards" of the PCAOB as described in section 700.[16] As noted in section 700,[17] reference to "the standards" of the PCAOB indicates that the auditor has complied not only with the PCAOB's auditing standards but also with the related professional practice standards of the PCAOB, including its independence rules, whereas a reference to "the auditing standards of the Public Company Accounting Oversight Board (United States)" is limited to compliance with the auditing standards of the PCAOB. The auditor of financial statements of an entity whose audits are not within the jurisdiction of the PCAOB may, nevertheless, be responsible for complying with the independence and other related professional practice standards of the PCAOB if, for example, the engagement is subject to regulatory oversight that requires compliance with those rules. Whether the auditor conducts an audit of financial statements in accordance with the standards of the PCAOB or the auditing standards of the PCAOB depends on the circumstances of the engagement.

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[14] See illustration 8, "An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Audit Has Been Conducted by a Nonregistered Firm in Accordance With Both Auditing Standards Generally Accepted in the United States of America and the Auditing Standards of the Public Company Accounting Oversight Board," in the exhibit to section 700.

[15] Paragraph .A15 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

[16] Paragraph .A62 of section 700.

[17] See footnote 10 and paragraph .A62.

.21 The exhibit to section 700[18] contains examples of auditor's reports on comparative financial statements when the audits are conducted in accordance with both GAAS and either the standards of the PCAOB or the auditing standards of the PCAOB.

[Issue Date: March 2018; Revised: March 2020.]

5. Communicating Critical Audit Matters When Reporting on Audits Conducted in Accordance WithAuditing Standards Generally Accepted in the United States of Americaand the Standards of the PCAOB

.22 *Question* — When reporting on audits of nonissuer entities that are not within the jurisdiction of the PCAOB as defined by the Sarbanes-Oxley Act of 2002, as amended, but conducted in accordance with the standards of the PCAOB and GAAS, is the auditor required to communicate critical audit matters (CAMs) in accordance with paragraphs .11–.17 of AS 3101?

.23 *Interpretation* — Section 700[19] states that the auditor should not refer to having conducted an audit in accordance with another set of auditing standards in addition to GAAS unless the audit was conducted in accordance with both sets of standards in their entirety. Section 700[20] also states that "…when the auditor refers to the standards of the PCAOB in addition to GAAS in the auditor's report, the auditor should use the form of report required by the standards of the PCAOB, amended to state that the audit was also conducted in accordance with GAAS."

.24 Accordingly, the auditor would follow the relevant requirements in the PCAOB standards regarding the determination and reporting of critical audit matters. This would not affect the requirement for the auditor to state in the auditor's report that the audit was also conducted in accordance with GAAS, as required by section 700.[21]

.25 Note that paragraph .05*b* of AS 3101 lists entities for which communication of CAMs is not required, including brokers and dealers, investment companies registered under the Investment Company Act of 1940, employee stock purchases, savings and similar plans, and emerging growth companies. Whether a nonissuer is such an entity is a matter for management to determine, and may involve consultation with management's legal counsel, based on the entity's circumstances.

.26 Accordingly, an auditor should apply all the requirements for CAMs set forth in AS 3101 unless it is determined by management that the entity is not subject to CAM reporting as described previously.

[Issue Date: October 2019; Revised: March 2020.]

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[18] See illustration 7, "An Auditor's Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Audit Has Been Conducted by a Registered Firm in Accordance With Both Auditing Standards Generally Accepted in the United States of America and the Auditing and Professional Practice Standards of the Public Company Accounting Oversight Board," and illustration 8.

[19] Paragraph .44 of section 700.

[20] Paragraph .46 of section 700.

[21] Paragraph .28 of section 700.