AU-C Section 9700

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

New and Revised IAASB Auditor Reporting Standards

In January 2015, the International Auditing and Assurance Standards Board (IAASB) issued new and revised International Standards on Auditing (ISA) relating to reporting on audited financial statements (hereinafter referred to as the *new and revised ISAs*). In April 2015, the IAASB issued ISA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*, which contained conforming amendments to certain of the reporting ISAs. The following is a list of the significant new and revised ISAs relating to reporting on a complete set of general purpose financial statements.

- ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*
- ***New*** ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*
- ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*
- ISA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*
- ISA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*
- ISA 570 (Revised), *Going Concern*

The new and revised standards are effective for audits of financial statements for periods ending on or after December 15, 2016.

The following is a brief summary of the key changes in the auditor reporting requirements under the new and revised ISAs. AU-C appendix B, *Substantive Differences Between the International Standards on Auditing and Generally Accepted Auditing Standards* (AICPA *Professional Standards*), will be updated to reflect the issuance of the new and revised ISAs after their effective date.

For all audits of financial statements:

a. Requires use of a specific form of report, unless law or regulation of a local jurisdiction prescribe otherwise

b. Requires the "Basis for Opinion" section of the auditor's report to include an affirmative statement about the auditor's independence and fulfillment of relevant ethical responsibilities, with disclosure of the origin of those requirements

c. Expands the description of the responsibilities of management, including when those responsible for the oversight of the financial reporting process differ from those responsible for the preparation of the financial statements

d. Expands the description of the responsibilities of the auditor and key features of an audit with the provision that certain components of this description may be presented in an appendix to the auditor's report or referenced to a website of an appropriate authority when law or regulation or auditing standards of a specific jurisdiction (national auditing standards) expressly permit such reference

e. Requires a description of the respective responsibilities of management and the auditor related to going concern

f. Requires, when applicable, a section that addresses the reporting requirements in ISA 720 (Revised)

For audits of financial statements of listed entities (voluntary for other than listed entities):

a. Requires key audit matters (KAM) to be communicated for audits of complete sets of general purpose financial statements. When KAM are communicated on a voluntary basis in audits of other than listed entities, ISA 701 should be followed.

b. Requires the name of the engagement partner to be included in the auditor's report, unless, in rare circumstances, such disclosure is reasonably expected to lead to a significant personal security threat.

Auditing Interpretation No. 3, "Reporting on Audits Conducted in Accordance With Auditing Standards Generally Accepted in the United States of America and International Standards on Auditing" (paragraphs .08–.13), addresses how the auditor might report when the audit is conducted in accordance with generally accepted auditing standards (GAAS) and the ISAs, and the new and revised ISAs have been adopted.

3. Reporting on Audits Conducted in Accordance With Auditing Standards Generally Accepted in the United States of America and International Standards on Auditing

.08 *Question*—AU-C section 700, *Forming an Opinion and Reporting on Financial Statements* (AICPA, *Professional Standards*), requires the auditor's report to state that the audit was conducted in accordance with GAAS and identifies the United States of America as the country of origin of those standards.[8] They also state that an auditor may indicate that the audit was also conducted in accordance with another set of auditing standards (for example, ISAs, the standards of the Public Company Accounting Oversight Board, or Government Auditing Standards). 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.[9] In accordance with AU-C section 700, when the auditor's report refers to GAAS and another set of auditing standards, the auditor's report should identify the other set of auditing standards as well as their origin.[10] In January 2015, the IAASB released new and revised standards related to auditor reporting. The new and revised ISAs include several revisions to the layout and wording of the auditor's report. Accordingly, what are the implications for the auditor's report when reporting on an audit conducted in accordance with both GAAS and the new and revised ISAs when the auditor intends to refer to both sets of standards?

.09 *Interpretation*—When the auditor has conducted an audit in accordance with both GAAS and the new and revised ISAs in their entirety, the auditor may refer to both sets of standards in the auditor's report, provided the auditor complies with the requirements of those standards.

.10 In accordance with paragraph 51 of ISA 700 (Revised), the auditor's report may refer to the ISAs in addition to the national auditing standards, but the auditor should do so only if

a. there is no conflict between the requirements in the national auditing standards and those in the ISAs that would lead the auditor (i) to form a different opinion, or (ii) not to include an emphasis-of-matter paragraph or other-matter paragraph that, in the particular circumstances, is required by the ISAs; and

b. the auditor's report includes, at a minimum, each of the elements set out in paragraph 50(a)–(o) of ISA 700 (Revised) when the auditor uses the layout or wording specified by the national auditing standards. However, reference to "law or regulation" in paragraph 50(k) of ISA 700 (Revised) should be read as

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[8] Paragraph .42 of AU-C section 700, *Forming an Opinion and Reporting on Financial Statements* (AICPA, *Professional Standards*).
[9] See footnote 8.
[10] Paragraph .43 of AU-C section 700.

reference to the national auditing standards. The auditor's report should thereby identify such national auditing standards.

.11 Accordingly, paragraph 50 of ISA 700 (Revised) allows the auditor to use the layout or wording of the national auditing standards, provided that (1) there are no conflicts between the requirements in GAAS and the ISAs that would lead to a different conclusion with respect to the opinion, and (2) it addresses, and is not inconsistent with, certain of the required minimum reporting elements in ISA 700 (Revised). The minimum elements exclude certain ISA 700 (Revised) requirements, such as placing the opinion paragraph first in the report.

.12 The following list summarizes the minimum elements set out in paragraph 50 of ISA 700 (Revised) that are required to be included in the auditor's report, if applicable, when reporting in accordance with GAAS and the ISA (*emphasis added* to highlight those elements that allow flexibility in meeting the required elements). The following reporting examples illustrate how an auditor might include these elements in a GAAS form of report:

a. A title.

b. An addressee, as required by the circumstances of the engagement.

c. An "Opinion" section containing an expression of opinion on the financial statements and a reference to the applicable financial reporting framework used to prepare the financial statements (including identifying the jurisdiction of origin of the financial reporting framework that is not International Financial Reporting Standards or International Public Sector Accounting Standards).

d. An identification of the entity's financial statements that have been audited.

e. A statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements. The statement should identify the jurisdiction of origin of the relevant ethical requirements or refer to the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants* (IESBA Code).

f. When applicable, *a section that addresses, and is not inconsistent with,* the reporting requirements in paragraph 22 of ISA 570 (Revised)

g. When applicable, a "Basis for Qualified (or "Adverse") Opinion" section that *addresses, and is not inconsistent with,* the reporting requirements in paragraph 23 of ISA 570 (Revised).

h. When applicable, a section that includes the information required by ISA 701, or additional information about the audit that is prescribed by law or regulation and that *addresses, and is not inconsistent with,* the reporting requirements in that ISA.[11]

i. When applicable, a section that addresses the reporting requirements in paragraph 24 of ISA 720 (Revised).

j. A description of management's responsibilities for the preparation of the financial statements and an identification of those responsible for the oversight of the financial reporting process that *addresses, and is not inconsistent with,* the requirements in paragraphs 33–36 of ISA 700 (Revised).

k. A reference to the ISAs and the law or regulation, and a description of the auditor's responsibilities for an audit of the financial statements that *addresses, and is not inconsistent with,* the requirements in paragraphs 37–40 of ISA 700 (Revised).

l. For audits of complete sets of general purpose financial statements of listed entities, the name of the engagement partner unless, in rare circumstances, such disclosure is reasonably expected to lead to a significant personal security threat.

m. The auditor's signature.

n. The auditor's address.

o. The date of the auditor's report.

.13 The following are two examples of auditor's reports on consolidated comparative financial statements when the audits are conducted in accordance with GAAS and the new and revised ISAs, and the auditor is referencing both standards in the report.

Example 1

Auditor's Report in Accordance With GAAS and ISAs When the Financial Statements Are Prepared in Accordance With International Financial Reporting Standards as Issued by the International Accounting Standards Board

Circumstances include the following:

[11] See paragraphs 11–16 of ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report.*

- Audit of a complete set of general purpose consolidated financial statements (comparative) of a nonissuer. The audit is a group audit of an entity with subsidiaries. (ISA 600 and AU-C section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* [AICPA, *Professional Standards*] apply.)

- The consolidated financial statements are prepared by management in accordance with International Financial Reporting Standards (IFRSs), as issued by the International Accounting Standards Board.

- The auditor has concluded that an unmodified opinion is appropriate based on the audit evidence obtained, and no emphasis-of-matter or other-matter paragraphs are included.

- The relevant ethical requirements that apply to the audit comprise AICPA's ethical requirements and the IESBA Code.

- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

  Note: If the auditor were to have concluded that a material uncertainty exists and adequate disclosure about the material uncertainty is made in the financial statements, then the auditor would be required to include a separate section under the heading "Material Uncertainty Related to Going Concern" in accordance with paragraph 22 of ISA 570 (Revised). When reporting in accordance with GAAS and the ISAs, this may be achieved by adding an emphasis-of-matter paragraph to the auditor's report with such a heading and appropriate content.

- KAM are not required to be communicated and have not been communicated as permitted by ISA 701.

  Note: When key audit matters are included in the auditor's report, a section that includes the information required by ISA 701 would need to be added to the auditor's report. This may be achieved by placing the information under the heading "Key Audit Matters" in a location that, in the auditor's judgment, is appropriate. In addition, information would be added to the auditor's responsibilities section relating to KAM, in accordance with paragraph 40(c) of ISA 700 (Revised).

- Those responsible for the oversight of the financial reporting process differ from those responsible for the preparation of the financial statements.

- No other information has been obtained as of the date of the auditor's report and, therefore, ISA 720 (Revised) does not apply.

  Note: When other information has been obtained prior to the date of the auditor's report, a section that reports in accordance with the reporting requirements in ISA 720 (Revised) would need to be added to the auditor's report. This may be achieved by adding an other-matter paragraph to the auditor's report with an appropriate heading and content.

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements[12]

We have audited the accompanying consolidated financial statements of ABC Company and its subsidiaries (the Group), which comprise the consolidated statements of financial position as of December 31, 20X1 and 20X0, and the related consolidated statements of comprehensive income, changes in equity and cash flows for the years then ended, and the related notes to the financial statements.

We are independent of the Group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the United States of America, together with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants*, and we have fulfilled our other ethical responsibilities in accordance with these requirements, respectively.

Responsibilities of Management and Those Charged With Governance for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board; 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 responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting, unless management either intends to liquidate the Group or to cease operations or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

Auditor's Responsibility

[12] The subtitle "Report on the 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 conducted our audits in accordance with auditing standards generally accepted in the United States of America and the International Standards on Auditing. 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, whether due to fraud or error. Reasonable assurance is a high level of assurance but is not a guarantee that an audit 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 taken on the basis of these consolidated financial statements.

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. We design 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 because fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

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 Group's internal control. 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, structure, and content of the consolidated financial statements, including disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

As part of an audit, we exercise professional judgment and maintain professional skepticism throughout the audit. We also

- conclude on the appropriateness of management's use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision, and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies or material weaknesses in internal control that we identify 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 accompanying consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the consolidated financial performance and their consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board.

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*]

Example 2

Auditor's Report in Accordance With GAAS and ISAs When the Financial Statements Are Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America

Circumstances include the following:

- Audit of a complete set of general purpose consolidated financial statements (comparative) of a nonissuer. The audit is a group audit of an entity with subsidiaries. (ISA 600 and AU-C section 600 apply.)

- The consolidated financial statements are prepared by management in accordance with accounting principles generally accepted in the United States of America (GAAP).

- The auditor has concluded an unmodified opinion is appropriate based on the audit evidence obtained, and no emphasis-of-matter or other-matter paragraphs are included.

- The relevant ethical requirements that apply to the audit comprise AICPA's ethical requirements and the IESBA Code.

- FASB *Accounting Standards Codification* (ASC) 205-40 has not been adopted.

  Note: If FASB ASC 205-40 has been adopted, then management is expressly required to evaluate whether there are conditions or events in the aggregate that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued (or available to be issued). Accordingly, the information under "Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements" that addresses management's responsibilities for assessing the use of the going concern basis of accounting would be revised to reflect the requirements in FASB ASC 205-40. The following is an example of such a paragraph.

  In preparing the consolidated financial statements, management is responsible for evaluating whether there are conditions and events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued, or available to be issued, and disclosing, as applicable, matters related to this evaluation unless the liquidation basis of accounting is being used by the entity.

- Based on the audit evidence obtained, the auditor has concluded that there is no substantial doubt about the entity's ability to continue as a going concern. [*The information contained in this illustration relating to going concern is not inconsistent with the requirements in ISA 570 (Revised) and has been presented to align with the accounting framework, in this case, GAAP.*]

  Note: If, after considering identified conditions or events and management's plans, the auditor were to have concluded that there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time and adequate disclosure with respect to the entity's ability to continue as a going concern is made in the financial statements, then the auditor would be required to include a separate section in the auditor's report. When reporting in accordance with GAAS and the ISAs, this may be achieved by adding an emphasis-of-matter paragraph to the auditor's report with an appropriate heading and appropriate content.

  If adequate disclosure about the entity's ability to continue as a going concern for a reasonable period of time is not made in the financial statements, the auditor would modify the opinion on the financial statements, as appropriate.

- KAM are not required to be communicated and have not been communicated as permitted by ISA 701.

  Note: When key audit matters are included in the auditor's report, a section that includes the information required by ISA 701 would need to be added to the auditor's report. This may be achieved by placing the information under the heading "Key Audit Matters" in a location that, in the auditor's judgment, is appropriate. In addition, information would be added to the auditor's responsibilities section relating to KAM, in accordance with paragraph 40(c) of ISA 700 (Revised).

- Those responsible for the oversight of the financial reporting process differ from those responsible for the preparation of the financial statements.

- No other information has been obtained as of the date of the auditor's report and, therefore, ISA 720 (Revised) does not apply.

  Note: When other information has been obtained prior to the date of the auditor's report, a section that reports in accordance with the reporting requirements in ISA 720 (Revised) would need to be added to the auditor's report. This may be achieved by adding an other-matter paragraph to the auditor's report with an appropriate heading and content.

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements[13]

We have audited the accompanying consolidated financial statements of ABC Company and its subsidiaries (the Group), 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.

We are independent of the Group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the United States of America together with the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants* and we have fulfilled our other ethical responsibilities in accordance with these requirements, respectively.

Responsibilities of Management and Those Charged With Governance 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. This also includes assessing that the consolidated financial statements are prepared using the appropriate basis of accounting.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

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 and the International Standards on Auditing. 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, whether due to fraud or error. Reasonable assurance is a high level of assurance but is not a guarantee that an audit 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 taken on the basis of these consolidated financial statements.

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

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. We design 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 because fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

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 Group's internal control. 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, structure, and content of the consolidated financial statements, including disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

As part of an audit, we exercise professional judgment and maintain professional skepticism throughout the audit. We also

- conclude on the appropriateness of management's use of the going concern basis of accounting and based on the audit evidence obtained, whether substantial doubt exists related to the Group's ability to continue as a going concern. If we conclude that substantial doubt exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision, and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies or material weaknesses in internal control that we identify 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 accompanying consolidated financial statements referred to above present fairly, in all material respects, the consolidated 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*]

[Issue Date: April 2016.]