AUD

1

# Audit Reports

## Module


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# 1 Professional Standards

The Auditing and Attestation section tests audits of issuers, nonissuers, governmental entities, not-for-profit entities, and employee benefit plans. In addition to audits, this section also tests other types of engagements that an accountant may be called upon to perform, such as accounting and review service engagements and attestation and assurance engagements. Each engagement requires the accountant to follow the applicable ethical guideline(s) and standard(s) for the engagement. For example, an audit engagement requires the auditor to perform the audit in accordance with generally accepted auditing standards (GAAS). These engagements and applicable standards will be covered in more detail in later modules.

Below is an overview of standards and guidelines that will be tested in this section:

| Professional Standards and Guidelines | | | | |
|---|---|---|---|---|
| *Standard/ Guideline* | *Section Reference* | *Standard-Setting Body* | *Description* | *Applies to:* |
| **Audits** | | | | |
| Statements on Auditing Standards (SAS) | AU-C | AICPA Auditing Standards Board | SAS provide generally accepted auditing standards for the audits of **nonissuers**. In addition, SAS provide guidance for other services, such as review of interim financial information and letters to underwriters. | • Audits of annual historical financial statements: nonissuers<br>• Special reports: nonissuers<br>• Interim financial statements (where the annual financial statements have been audited): nonissuers |
| Public Company Accounting Oversight Board Auditing Standards (PCAOB AS) | PCAOB AS | Public Company Accounting Oversight Board | PCAOB AS provide generally accepted auditing standards for the audits of **issuers**. In addition, PCAOB AS provide guidance for other services, such as review of interim financial information and letters to underwriters. | • Audits of annual historical financial statements: issuers<br>• Special reports: issuers<br>• Interim financial statements: issuers |
| Generally Accepted Government Auditing Standards (GAGAS) | GAGAS | Governmental Accountability Office | GAGAS provide guidance for audits of **government** organizations, programs, activities, and of entities that receive government funds. | Financial or performance audits of government organizations, programs, activities, and of entities that receive government funds. |

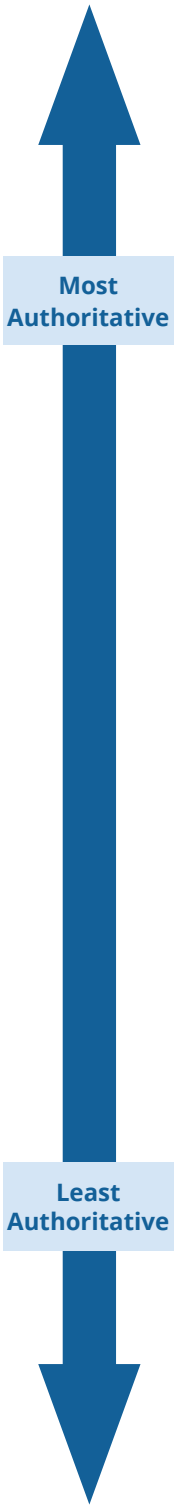
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| *Standard/ Guideline* | *Section Reference* | *Standard-Setting Body* | *Description* | *Applies to:* |
|---|---|---|---|---|
| **Other Engagements** | | | | |
| Statements on Standards for Attestation Engagements (SSAE) | AT-C | AICPA | SSAE provide guidance for attestation engagements. | Examination, a review, or agreed-upon procedures report on a subject matter, or an assertion about a subject matter, that is the responsibility of another party. |
| Statements on Standards for Accounting and Review Services (SSARS) | AR-C | AICPA Accounting and Review Services Committee | SSARS provide guidance for **unaudited** financial statements or unaudited financial information of **nonissuers**. | • Preparation, compilation, and reviews of historical financial statements: nonissuers<br>• Preparation or compilation of pro forma financial information and forecasts: nonissuers |
| **Guidelines** | | | | |
| Code of Professional Conduct | ET | AICPA | The AICPA Code of Professional Conduct provides **members** with guidelines for **behavior** in the conduct of their professional affairs. In addition, it provides assurance to the public that the profession intends to maintain high standards and to enforce compliance with these standards by its members. | Members of the AICPA |
| Statements on Quality Management Standards (SQMS) | SQMS | AICPA | SQMS provides guidance to **CPA firms** about a system of quality management. A quality management system consists of policies and procedures designed, implemented, and maintained to ensure that the firm complies with professional standards and appropriate legal and regulatory requirements, and that any reports issued are appropriate in the circumstances. | CPA firms providing auditing, attestation, and accounting and review services. |


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# 2 Auditing Guidance: The GAAS Hierarchy

There are three levels of audit guidance:




## 1. SAS (Nonissuers) and PCAOB AS (Issuers)

The auditor should:

- Use professional judgment in applying the SAS or PCAOB AS to a particular engagement.
- Be prepared to justify any departures from presumptively mandatory requirements.

Specific language is used within the standards to clarify the auditor's level of responsibility:

- **"Must"** or **"is required"** indicates an unconditional requirement, which must be followed in all cases in which the requirement is relevant.
- **"Should"** indicates a presumptively mandatory requirement, which must be followed in all cases in which the requirement is relevant, except in rare circumstances when departure from the requirement is permitted if there is appropriate justification, performance of sufficient alternative procedures, and thorough documentation.
- "**May," "might,"** and **"could"** indicate explanatory material that does not impose a professional requirement for performance.

## 2. Interpretive Publications

Interpretive publications are recommendations regarding how SASs should be applied in specific situations. They are not considered to be auditing standards.

The auditor should:

- Consider the guidance provided by these publications in performing an audit.
- Be able to explain any departures, and how compliance with standards was otherwise achieved.

Examples include: Auditing interpretations of GAAS, exhibits to GAAS, auditing guidance provide in AICPA Audit and Accounting Guides, and AICPA Auditing Statements of Position (SOP).

## 3. Other Auditing Publications

Other auditing publications have no authoritative status but may be helpful to the auditor.

The auditor should:

- Consider the guidance provided by these publications in performing an audit.
- Be able to explain any departures, and how compliance with standards was otherwise achieved.

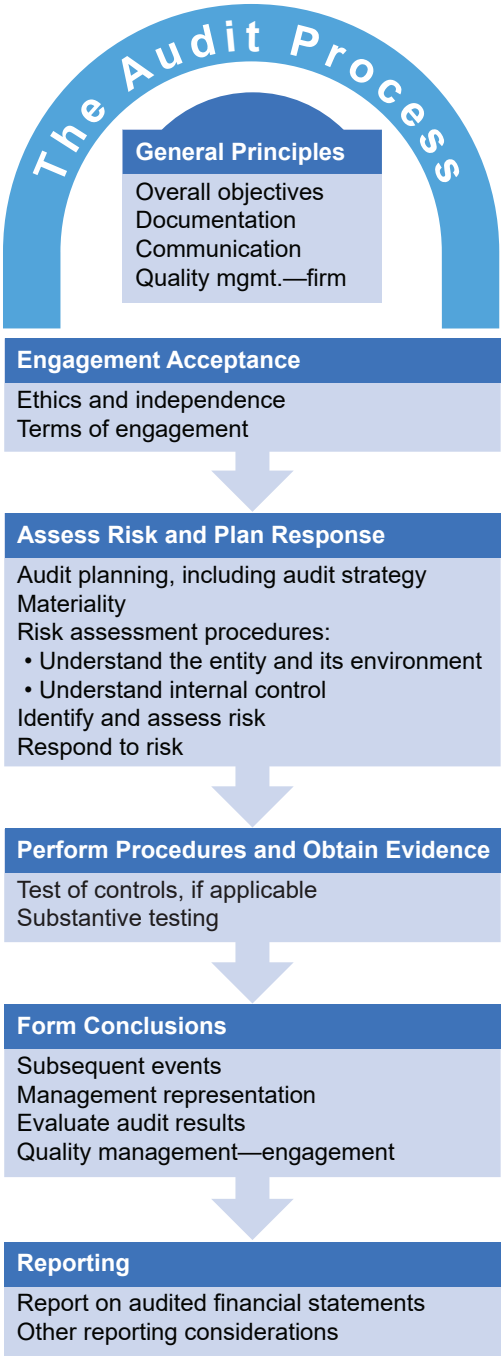
Examples include: Auditing articles in the *Journal of Accountancy* (or other professional journal), auditing articles in the AICPA CPA Letter, continuing professional education materials, textbooks, and other auditing publications.

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## NOTES


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## 1 Audit Process Overview




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# 2 The Independent Audit Function: The Basics

The purpose of an audit is to provide financial statement users with an opinion on whether the financial statements are presented fairly, in all material respects, in accordance with the *applicable financial reporting framework*.



**Pass Key**

The *applicable financial reporting framework* is the financial reporting framework that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation. Acceptable financial reporting frameworks include general purpose frameworks designed to meet the needs of a wide range of users (e.g., U.S. GAAP and International Financial Reporting Standards [IFRSs]), and special purpose frameworks.

The auditor's report gives credibility to the financial statements. The auditors, as a group independent of management, have an objective view and can report on a company's activities without bias or conflict of interest. Without a report from an independent auditor, a company's financial statements would be meaningless, because the public would have little faith in financial statements issued by the inherently biased company.

The financial statements of an enterprise are prepared by the management of the enterprise, not by the independent auditor. Further, the financial statements are the product and property of the enterprise; the independent auditor merely audits and expresses an opinion on them.

## 2.1 Management Responsibilities

An audit is conducted on the premise that management and, when appropriate, those charged with governance are responsible for:

1. the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework;
2. the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement due to error or fraud; and
3. providing the auditor with access to information and persons within the entity needed to complete the audit.



**Pass Key**

The preparation and fair presentation of the financial statements requires:

1. identification of the applicable financial reporting framework;
2. preparation and fair presentation of the financial statements in accordance with the framework; and
3. inclusion of an adequate description of the framework in the financial statements.


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## 2.2 Auditor Responsibilities

The auditor is responsible for expressing an opinion on the financial statements based on the audit. The auditor is also responsible for:

1. maintaining professional skepticism;
2. complying with relevant ethical requirements;
3. exercising professional judgment throughout the planning and performance of the audit;
4. obtaining sufficient appropriate audit evidence; and
5. complying with generally accepted auditing standards (GAAS).

### 2.2.1 Professional Skepticism

The auditor should plan and perform the audit with professional skepticism. Professional skepticism is an attitude that the auditor must apply when making professional judgments that provide the basis for the auditor's actions. Professional skepticism is necessary to the critical assessment of audit evidence. Auditors should be alert for:

- Audit evidence that contradicts other audit evidence obtained.
- Information that calls into question the reliability of documents (including the identified controls over the preparation and maintenance of such information) and responses to inquiries that may be used as audit evidence.
- Conditions that indicate possible fraud.
- Circumstances that suggest the need for audit procedures in addition to those required by GAAS.
- Audit evidence that may impact the auditor's consideration of the initial identification and assessment of the risks of material misstatement.



**Pass Key**

The auditor should neither assume that management is dishonest nor assume unquestioned honesty. A belief that management is honest and has integrity does not relieve the auditor of the need to maintain professional skepticism or allow the auditor to be satisfied with less than persuasive evidence.

### 2.2.2 Impediments to Acting With Professional Skepticism

An auditor should act with professional skepticism throughout the audit. However, auditors often feel challenged to meet this requirement because of impediments to applying professional skepticism during an audit. Examples of impediments include:

- Unconscious human bias, which may cause the auditor to evaluate and recall information that favors the interest of the client over the interest of the investor or favors evidence that corroborates, rather than contradicts, the existence of risks. This may be facilitated by incentives and pressures to maintain and build client relationships, provide an unmodified (unqualified) opinion, keep audit costs low, or cross-sell other services.
- Development of an inappropriate level of trust or confidence in management, which may result in the auditor not taking as questioning a stance as needed.

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- Pressure to avoid potential negative interactions with, or consequences to, individuals whom auditors know (e.g., management) instead of representing the interest of investors.
- Scheduling and workload demands, which may result in auditors making shortcuts in judgment, such as seeking audit evidence that is easier to obtain rather than evidence that is more reliable and relevant, or giving more weight to supporting evidence without considering contrary evidence.

### 2.2.3 Ethical Requirements

The auditor should comply with ethical requirements related to financial statement audit engagements, including *independence in both fact and appearance.* Ethical requirements include the AICPA Code of Professional Conduct and the rules of the state boards of accountancy and applicable regulatory agencies that are more restrictive.



**Pass Key**

The auditor must be independent of an entity when performing an engagement in accordance with GAAS unless: a) GAAS provides otherwise, or b) the auditor is required by law or regulation to accept the engagement and report on the financial statements.

### 2.2.4 Professional Judgment

The auditor should exercise professional judgment in planning and performing an audit. Professional judgment is necessary because an audit requires interpretation of ethical requirements and GAAS, as well as informed decisions based on the application of knowledge and experience.

In an audit, professional judgment is necessary when making decisions about:

- Materiality
- Audit risk
- The nature, extent, and timing of audit procedures
- Evaluating whether sufficient, appropriate evidence has been obtained
- Evaluating management's judgments in applying the applicable financial reporting framework
- Drawing conclusions based on the audit evidence obtained

### 2.2.5 Sufficient Appropriate Audit Evidence and Audit Risk

To obtain reasonable assurance, the auditor should obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion.

### 2.2.6 Compliance With GAAS

The auditor should not represent compliance with GAAS in the auditor's report unless the auditor has complied with all GAAS relevant to the audit. If the objective of a relevant GAAS section cannot be achieved, the auditor should consider whether this prevents the auditor from achieving the overall objectives of the auditor and thereby requires the auditor, in accordance with GAAS, to modify the auditor's opinion or withdraw from the engagement.


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In certain audit engagements, the auditor may be required to comply with other auditing requirements in addition to GAAS. GAAS do not override laws or regulations that govern an audit of financial statements. The auditor may conduct the audit in accordance with both GAAS and:

- auditing standards issued by the PCAOB;
- requirements of the Employee Retirement Income Security Act of 1974 (ERISA);
- International Standards on Auditing (ISAs);
- government auditing standards (GAGAS); or
- auditing standards of a specific jurisdiction or country.

## 2.3 Reasonable Assurance and Inherent Limitations of an Audit

In order to express an opinion, the auditor obtains reasonable assurance about whether the financial statements are free from material misstatement, whether due to error or fraud.

Reasonable assurance is a high, but not absolute, level of assurance. In order to obtain reasonable assurance, the auditor must:

1. plan the work and properly supervise any assistants;
2. determine and apply appropriate materiality levels;
3. identify and assess risks of material misstatement, whether due to fraud or error; and
4. obtain sufficient appropriate audit evidence.

The auditor is unable to obtain absolute assurance that the financial statements are free from material misstatement because of the following inherent limitations:

- **The Nature of Financial Reporting:** Some financial statement items are subject to an inherent level of variability because they involve judgment by management or because they involve subjective decisions or assessments or a degree of uncertainty (e.g., accounting estimates).
- **The Nature of Audit Procedures:** There are practical and legal limits on an auditor's ability to obtain audit evidence, including:
  - The possibility that management or others may not provide, intentionally or unintentionally, the complete information that is needed for the preparation and presentation of the financial statements or that is requested by the auditor.
  - Fraud may be concealed in such a way that it is difficult to detect with audit procedures.
  - An audit is neither an investigation into a wrongdoing nor does the auditor have specific legal powers.
- **Timeliness of Financial Reporting and the Balance Between Cost and Benefit:** There is an expectation by users of financial statements that the auditor will form an opinion on the financial statements within a reasonable period of time and will achieve a balance between benefit and cost, recognizing that it is impracticable to address all information that may exist. Therefore, it is necessary for the auditor to:
  - plan the audit so that it is performed effectively;
  - direct efforts to areas most expected to contain risks of material misstatement; and
  - use testing and other means of examining populations for misstatement.

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# 3 Determine the Nature and Scope of the Engagement

The following should be considered as the auditor, the audit committee, and management determine the appropriate nature and scope of the engagement:

- An auditor may be hired to perform an audit for a single period or multiple periods.
- An audit may be on the complete financial statement; single financial statement; or specific elements, accounts, or items of a financial statement.
- Many audit firms are hired to perform tax services in addition to audit services.

## 3.1 Nonissuers

When auditing nonissuers, the auditor must determine if an audit is the most appropriate engagement, or whether a review, compilation, or preparation may be more appropriate. If an audit is needed, nonissuers have the choice of:

- a financial statement audit only (where one opinion is rendered on the fairness of the financial statements); or
- an integrated audit (where two opinions are rendered: one opinion on the fairness of the financial statements and one opinion on the operating effectiveness of internal controls over financial reporting).

## 3.2 Issuers

When auditing issuers, the auditor must perform an integrated audit of the client's financial statements and internal controls over financial reporting (covered later).

# 4 Overall Objectives of Audit Engagements

## 4.1 Objectives of the Financial Statement Audit

The overall objectives of the auditor when conducting a financial statement audit (which apply to audits of issuers, nonissuers, and governmental entities) are:

1. to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to error or fraud, which enables the auditor to express an opinion on whether the financial statements are presented fairly, in all material respects, in accordance with an applicable financial reporting framework; and
2. to report on the financial statements and communicate as required by GAAS based on the auditor's findings.


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## 4.2 Objectives of the Audit of Internal Control Over Financial Reporting

Issuers are required to have an integrated audit of financial statements and internal control over financial reporting. In some cases, nonissuers and governmental entities may also have an audit of internal control over financial reporting. The overall objectives of the auditor when conducting an audit of internal control over financial reporting are:

1. Express an opinion on the effectiveness of the company's internal control over financial reporting; and
2. Plan and perform the audit to obtain appropriate evidence that is sufficient to obtain reasonable assurance about whether material weaknesses exist as of the date specified in management's assessment.

Audits of internal control over financial reporting must be integrated with an audit of the financial statements.

## 4.3 Objectives of the ERISA Plan Financial Statements Audit

The overall objectives of the auditor when conducting an ERISA plan financial statement audit are:

- Accept an ERISA plan audit engagement when the basis upon which it is to be performed has been agreed upon through establishing whether the preconditions for the audit are present.
- Appropriately plan and perform the audit of ERISA plan financial statements, including procedures required by this SAS on the certified investment information when management elects an ERISA Section 103(a)(3)(C) audit.
- Form an opinion on the ERISA plan financial statements based on an evaluation of the audit evidence obtained, including evidence obtained about comparative financial statements.
- Express clearly the opinion on the ERISA plan financial statements through a written report.
- Perform procedures and report on the presentation of the supplementary information in accordance with this SAS.
- Appropriately communicate to management and those charged with governance reportable findings that the auditor has identified during the audit of the ERISA plan financial statements.

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## NOTES


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## 1 Forming an Opinion on the Financial Statements

The auditor should form an opinion on whether the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework.

In order to form that opinion, the auditor should take into account the following:

1. Whether sufficient appropriate audit evidence was obtained (as required by GAAS);
2. Whether uncorrected misstatements are material, individually or in the aggregate; and
3. Whether the financial statements are prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework (i.e., GAAP).

Financial statements generally mean a complete set of general-purpose financial statements, including disclosures. The applicable financial reporting framework determines the form and content of a complete set of financial statements. For example, under U.S. GAAP a complete set of financial statements includes a balance sheet, a statement of income (or comprehensive income), a statement of changes in equity, a cash flow statement, and disclosures.

When forming the opinion, the auditor should evaluate whether, based on the applicable financial reporting framework:

- The financial statements adequately disclose the significant accounting policies selected and applied, including a description of the applicable financial reporting framework.
- The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate.
- The accounting estimates and related disclosures made by management are reasonable.
- The information presented in the financial statements is relevant, reliable, comparable, and understandable.
- The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements.
- The terminology used in the financial statements, including the title of each financial statement, is appropriate.
- The overall structure and content of the financial statements is fairly presented.
- The financial statements, including disclosures, represent the underlying transactions and events in a manner that achieves fair presentation.

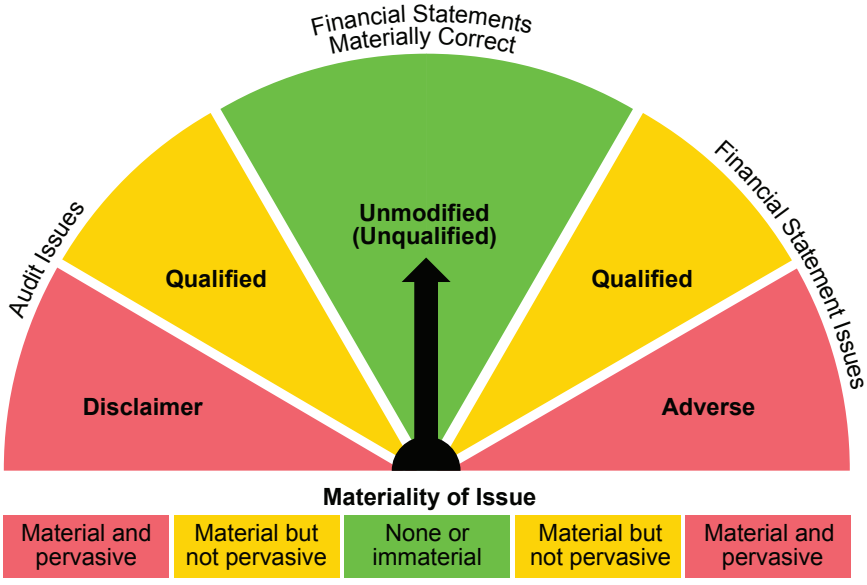
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**Pass Key**

The auditor refers to generally accepted auditing standards (GAAS) for guidelines on how to perform the audit (e.g., inventory count should be observed by the auditor).

The auditor refers to the financial reporting framework (e.g., U.S. GAAP) to evaluate whether the transactions are recorded and reported fairly in the financial statements (e.g., land should not be depreciated).

# 2 Types of Opinions




## 2.1 Unmodified (Unqualified) Opinion

An unmodified (unqualified) opinion states that the financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of the entity in conformity with the applicable financial reporting framework. Note that *unmodified* is the term used for nonissuers and *unqualified* is the term used for issuers.

In certain circumstances, the auditor may determine that it is necessary to add additional communications to the auditor's report without modifying the auditor's opinion. This is done using emphasis-of-matter, other-matter, and explanatory paragraphs. Nonissuers use the terms *emphasis-of-matter* and *other-matter*, and issuers use the term *explanatory*.


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## 2.2 Modifications to the Auditor's Opinion

The auditor's report should be modified when:

1. the auditor concludes that the financial statements as a whole are materially misstated (financial statement issue); or
2. the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement (audit issue).

### 2.2.1 Types of Modified Opinions

There are three types of modified opinions: the qualified opinion, the adverse opinion, and the disclaimer of opinion.

- **Qualified Opinion:** A qualified opinion states that except for the effects of the matter(s) to which the qualification relates, the financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of the entity in conformity with the applicable financial reporting framework.
- **Adverse Opinion:** An adverse opinion states that the financial statements do not present fairly the financial position, results of operations, or cash flows of the entity in conformity with the applicable financial reporting framework.
- **Disclaimer of Opinion:** A disclaimer of opinion states that the auditor does not express an opinion on the financial statements.



**Pass Key**

When the auditor expresses an adverse opinion or a disclaimer of opinion on the complete financial statements (i.e., balance sheet, statement of income, statement of changes in equity, statement of cash flows, and disclosures), the auditor's report should not also include an unmodified (unqualified) opinion on a single financial statement (e.g., the statement of cash flows) or one or more specific elements, accounts, or items of a financial statement. Issuing such an unmodified (unqualified) opinion in these circumstances would contradict the adverse opinion or the disclaimer of opinion on the complete financial statements.

### 2.2.2 Brief Summary of When to Use Different Opinions

The chart below summarizes when to use different opinions.

| Materiality of Problem | Financial Statements Are Materially Misstated (Financial Statement Issues) | Inability to Obtain Sufficient Appropriate Audit Evidence (Audit Issues) |
|---|---|---|
| None or immaterial | Unmodified (unqualified) | Unmodified (unqualified) |
| Material but not pervasive | Qualified opinion | Qualified opinion |
| Material and pervasive | Adverse opinion | Disclaimer of opinion |

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### 2.2.3 Definition of Pervasive

Pervasive effects on the financial statements are those which in the auditor's professional judgment:

- are not confined to specific elements, accounts, or items of the financial statements;
- if so confined, represent a substantial proportion of the financial statements; or
- are disclosures fundamental to the users' understanding of the financial statements.


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# 1 Unmodified Audit Opinion (Nonissuers)

The auditor of a nonissuer should express an unmodified opinion when the auditor concludes that the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. The auditor's report should be in writing. Note that nonissuers use the term *unmodified* and issuers use the term *unqualified*.

## 1.1 Contents of the Audit Report

The basic elements of the unmodified audit opinion are the following:

| Independent Auditor Report | |
|---|---|
| Title | Title clearly indicates that it is a report of an independent auditor. |
| Addressee | The report is addressed as required by the circumstances of the engagement. |
| Auditor's Opinion | The auditor's report should include a section with the heading "Opinion" that includes:<br>• The entity whose financial statements have been audited.<br>• A statement that the financial statements have been audited.<br>• The title of each statement that the financial statements comprise and reference to the notes.<br>• The dates or periods covered by each financial statement that the financial statements comprise.<br>• A statement that in the auditor's opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the entity as of the balance sheet date and the results of operations and its cash flows for the period then ended, in accordance with the applicable financial reporting framework.<br>• Identification of the applicable financial reporting framework and its origin. |
| Basis for Opinion | The auditor's report should include a section with the heading "Basis for Opinion" that includes:<br>• A statement that the audit was conducted in accordance with generally accepted auditing standards and identifies the United States of America as the country of origin of those standards (GAAS).<br>• A reference to the section of the auditor's report that describes auditor responsibilities under GAAS.<br>• A statement that the auditor is required to be independent and to meet other relevant ethical requirements.<br>• A statement as to whether the auditor believes that the evidence obtained is sufficient and appropriate to provide a basis for the auditor's opinion. |
| Substantial Doubt About the Entity's Ability to Continue as a Going Concern (When Relevant) | When relevant, the auditor should include a separate section in the auditor's report with the heading "Substantial Doubt About the Entity's Ability to Continue as a Going Concern" that:<br>• Draws attention to the note in the financial statements that discloses the conditions or events identified, management's plans to deal with the conditions or events, and states that they indicate that substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time.<br>• States that the auditor's opinion is not modified with respect to the matter. |

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| Key Audit Matters (When Engaged) | When engaged to communicate key auditor matters, the auditor should describe each key audit matter, using an appropriate subheading, in a separate section in the auditor's report with the heading "Key Audit Matters." The introductory language should state:<br>• Key audit matters are those matters that were communicated with those charged with governance and, in the auditor's professional judgment, were of most significance in the audit of the financial statements in the current period.<br>• These matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, and the auditor does not provide a separate opinion on these matters.<br>The description of each key audit matter should include a reference to the related disclosures, if any, in the financial statements, and should address the following:<br>• Why the matter was considered to be one of the most significant in the audit.<br>• How the matter was addressed in the audit.<br>The auditor should not communicate a matter in this section of the auditor's report when the auditor would be required to modify the opinion as a result of the matter. |
| Responsibilities of Management for the Financial Statements | The auditor's report should include a section with the heading "Responsibilities of Management for the Financial Statements" that includes:<br>• An explanation that management is responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework.<br>• A statement that this responsibility 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.<br>• When required, the evaluation of whether there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern. |
| Auditor's Responsibilities for the Audit of the Financial Statements | The auditor's report should include a section with the heading "Auditor's Responsibilities for the Audit of the Financial Statements" that includes:<br>• A statement that the objectives of the auditor are to obtain reasonable assurance about whether the financial statements are free from material misstatement, whether due to error or fraud, and to issue an auditor's report that includes the auditor's opinion.<br>• A statement that reasonable assurance is a high level of assurance but is not absolute assurance and, therefore, is not a guarantee a material misstatement will always be detected when it exists.<br>• A statement that the risk of not detecting a material misstatement resulting from fraud is higher than one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.<br>• A statement that misstatements are considered material if there is a substantial likelihood, individually or in the aggregate, they would influence the judgement made by a reasonable user based on the financial statements.<br>• A description of the audit that states the auditor's responsibilities are to:<br>— Exercise professional judgment and maintain professional skepticism.<br>— Identify and assess the risk of material misstatement of the financial statements, whether due to error or fraud, and design and perform audit procedures responsive to those risks.<br>— 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 entity's internal control, and accordingly, no such opinion is expressed.* (The italicized portion of this statement should be omitted if the auditor does have a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of financial statements.) |


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|---|---|
| Auditor's Responsibilities for the Audit of the Financial Statements<br><br>(continued) | —Evaluate the appropriateness of the accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.<br>—Conclude whether, in the auditor's judgment, there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time.<br>A statement that the auditor is 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 the audit. |
| Other Information (When Relevant) | When relevant, the auditor's report should include a separate section with the heading "Other Information" including:<br>• A statement that management is responsible for the other information.<br>• An identification of the other information and a statement that the other information does not include the financial statements and auditor's report thereon.<br>• A statement that the auditor's opinion does not cover the other information and the auditor does not express any opinion or form of assurance thereon.<br>• A statement that the auditor is responsible 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.<br>• A statement that if, based on the work performed, the auditor concludes that an uncorrected material misstatement of the other information exists, the auditor is required to describe it in the auditor's report.<br>• If the auditor has concluded that an uncorrected material misstatement of the other information exists, a statement that the auditor has concluded that an uncorrected material misstatement of the other information exists and a description of it in the auditor's report. |
| Other Reporting Responsibilities | If the auditor addresses other reporting responsibilities in the auditor's report in addition to GAAS, these other reporting responsibilities should be addressed in a separate section of the auditor's report subtitled "Report on Other Legal and Regulatory Responsibilities," or otherwise as appropriate.<br>If the audit report contains a separate section on other reporting responsibilities, the other sections of the audit report already described should be under the subtitle "Report on the Audit of the Financial Statements." The "Report on Other Legal and Regulatory Requirements" should follow the "Report on the Audit of the Financial Statements." |
| Signature of the Auditor | The auditor's report should include the manual or printed signature of the auditor's firm. |
| Auditor's Address | The auditor's report should name the city and state where the auditor's report is issued. |
| Date of the Auditor's Report | The auditor's report should be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements, including evidence that:<br>• all the financial statements, including the related notes, have been prepared; and<br>• management has asserted that it has taken responsibility for those financial statements. |



## Pass Key

The auditor's report date shows the final date of auditor responsibility. For comparative financial statements, the audit report date for the most recent audit should be used.

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## 1.1.1 Sample Report: Unmodified Opinion Excluding Communication of Key Audit Matters (Nonissuer)

**Independent Auditor's Report**

[*Appropriate Addressee*]

**Report on the Audit of Financial Statements**[1]

**Opinion**

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

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

**Basis for Opinion**

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

**Responsibilities of Management for the Financial Statements**

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

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

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

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

(continued)

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(continued)

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 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 evaluate 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 that we identified during the audit.

**Other Information [*Included in the Annual Report*]**

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.

**Report on Other Legal and Regulatory Requirements**

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.*]

[*Signature of the auditor's firm*]

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

[*Date of the auditor's report*]

[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.

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

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## 1.2 Reference to Auditing Standards in the Auditor's Report

### 1.2.1 Audits in Accordance With Two Sets of Standards

If the audit was conducted in accordance with two sets of auditing standards in their entirety, the auditor may indicate that the audit was conducted in accordance with another set of auditing standards (e.g., International Standards on Auditing or government auditing standards). Additional language should be added to the basis for opinion paragraph to describe this situation:

> We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS) and in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report.

### 1.2.2 Audits in Accordance With GAAS and PCAOB Standards

When conducting an audit of financial statements in accordance with the standards of the PCAOB and the audit is not required to be conducted in accordance with those standards, the auditor is required to also follow GAAS. In addition, the auditor should:

- Use the report required by the PCAOB.
- Amend the PCAOB (issuer) report to state the audit was also conducted in accordance with GAAS.

**Pass Key**

When the examiners require CPA candidates to respond to questions concerning the unmodified audit opinion (nonissuer), you must remember:

| | |
|---|---|
| GAAS → | Basis for opinion and auditor's responsibilities paragraphs |
| GAAP (U.S. or other applicable financial reporting framework) → | Management's responsibility and opinion paragraphs |

## 1.3 Key Audit Matters

### 1.3.1 Definition and Identification

Key audit matters (KAMs) are those matters that were of most significance in the audit of the financial statements of the current period. Such matters are selected from the matters communicated with those charged with governance. Entities (nonissuers) have the option of whether to engage the auditor to communicate key audit matters but should consider the needs of the users of the financial statements when making this determination.


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When deciding which matters, if any, should be communicated as KAMs, the auditor should consider the items that required significant auditor attention and consider the following:

- areas with a higher assessed risk of material misstatement;
- areas requiring significant auditor and management judgment, including accounting estimates subject to a high degree of estimation uncertainty; and
- significant events or transactions.

The determination of which matters to include as a KAM is ultimately a matter of professional judgment. The auditor may focus his or her consideration on areas that are complex or subjective, contain uncorrected misstatements or control deficiencies, required the attention of specialists, or where the auditor encountered difficulties in applying procedures or evaluating results.

### 1.3.2 Reporting KAMs in the Auditor's Report

When the auditor is engaged to communicate key audit matters, a description of each matter must be included in a separate section of the auditor's report. The following language, including the section title "Key Audit Matters", should be included in the auditor's report in proximity of the "Opinion" and "Basis for Opinion" sections:

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

Each key audit matter should include a description of why the matter was of most significance and how the matter was addressed in the audit of the financial statements.

If the auditor is engaged to communicate key audit matters, but determines, based on the facts and circumstances of the audit, that there are no items to communicate, a statement to this effect should be included in the auditor's report under the subheading "Key Audit Matters."

### 1.3.3 Other Reporting Considerations for KAMs

- The order of presentation and the adequacy of the description of each KAM is a matter of professional judgment. Each description is meant to enable intended users to understand the nature of and response to the matter and may include details such as an overview of procedures performed and related outcomes and observations.
- The auditor should describe each key audit matter in the auditor's report unless law or regulation precludes disclosure of the matter or, in rare circumstances, when the auditor determines that the adverse consequence of doing so outweighs the public interest benefits of such communication.
- Matters giving rise to a qualified opinion or when substantial doubt exists about an entity's ability to continue as a going concern for a reasonable period of time are by nature key audit matters, however, such matters should not be included in the "Key Audit Matters" section of the report but rather reference should be made to the "Basis for Opinion" or "Going Concern" section for further explanation.
- Auditors are prohibited from communicating key audit matters when the auditor expresses an adverse opinion or disclaims an opinion unless such reporting is required by law or regulation.

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### 1.3.4 Documentation of KAMs

Audit documentation should include a description of the matters that required significant auditor attention and the rationale for the auditor's determination about whether each matter was considered a key audit matter. When applicable, documentation should also include the rationale for the following:

- the auditor's determination that there were no key audit matters; or
- the auditor's decision not to communicate a matter determined to be a key audit matter.

# 2 Unqualified Audit Opinion (Issuers)

The auditor of an issuer should express an unqualified opinion when the auditor concludes that the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework (e.g., generally accepted accounting principles). The report should be in writing. In order to conclude that the financial statements are presented fairly in accordance with the applicable financial reporting framework, the auditor should also evaluate the statements to ensure:

- they are informative of matters that may affect their use or ability to be understood;
- the accounting principles selected and applied are appropriate; and
- transactions and events are appropriately recognized, measured, and disclosed.

## 2.1 Contents of the Audit Report

The basic elements of the unqualified audit opinion are the following:

| Unqualified Opinion: Issuer | |
|---|---|
| Title | The report must include the title, "Report of Independent Registered Public Accounting Firm." |
| Addressee | The report must be addressed to the shareholders and the board of directors. It generally is not addressed to management. |
| Opinion Section | The first section of the auditor's report must include the section title, "Opinion on the Financial Statements," and the following elements.<br>• The name of the company whose financial statements were audited.<br>• A statement identifying each financial statement and any related schedule that has been audited.<br>• The date of, or period covered by, each financial statement and related schedule identified in the report.<br>• A statement indicating that the financial statements were audited.<br>• An opinion that the financial statements present fairly, in all material respects, the financial position of the company as of the balance sheet date and the results of its operations and its cash flows for the period then ended in conformity with the applicable financial reporting framework. The opinion should also include an identification of the applicable financial reporting framework (e.g., GAAP). |


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| | |
|---|---|
| Basis for Opinion Section | The Basis for Opinion section contains the following:<br>• A statement that the financial statements are the responsibility of the company's management.<br>• A statement that the auditor's responsibility is to express an opinion on the financial statements based on the audit.<br>• A statement that the auditor is a public accounting firm registered with the PCAOB (United States) and 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.<br>• A statement that the audit was conducted in accordance with the standards of the PCAOB.<br>• A statement that PCAOB standards require that the auditor plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud.<br>• A statement that the audit included:<br>— performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks;<br>— examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements;<br>— evaluating the accounting principles used and significant estimates made by management; and<br>— evaluating the overall presentation of the financial statements.<br>• A statement that the auditor believes the audit provides a reasonable basis for the auditor's opinion. |
| Critical Audit Matters | The auditor's report must include the section entitled "Critical Audit Matters" and should include discussion of any critical audit matters (CAMs) arising from the current period's audit of the financial statements, or state that the auditor determined that there were no CAMs. |
| Signature, Tenure, Location | The audit report must include:<br>• The signature of the audit firm.<br>• A statement containing the year the auditor began serving consecutively as the company's auditor.<br>• The city and state (or country) from which the report was issued. |
| Report Date | The date of the audit report must be included in the report.<br>• The report should be dated on or after the date on which appropriate audit evidence, sufficient to support the opinion, has been obtained. Sufficient appropriate audit evidence includes evidence that:<br>— audit documentation has been reviewed;<br>— financial statements have been prepared; and<br>— management has taken responsibility for the financial statements.<br>• The report date shows the final date of the auditor's responsibility.<br>• For comparative statements, the date appropriate for the most recent audit should be used. |

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## 2.1.1 Sample Report: Unqualified Opinion (Issuer)

**Report of Independent Registered Public Accounting Firm**

To the shareholders and the board of directors of X Company:

**Opinion on the Financial Statements**

We have audited the accompanying balance sheets of X Company (the "Company") as of December 31, 20X2 and 20X1, the related statements of income, comprehensive income, stockholders equity, and cash flows for each of the years then ended, and the related notes and schedules (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 20X2 and 20X1, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

**Basis for Opinion**

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are 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 Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

**Critical Audit Matters**

The critical audit matters communicated below are matters arising from the current period audit of the financial statements that were communicated or required to be communicated to the audit committee and that: (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

[*Include critical audit matters*]

[*Signature*]

We have served as the Company's auditor since [*year*].

[*City and state or country*]

[*Date*]


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### 2.1.2 Critical Audit Matters (CAMs): Definition and Identification

The auditor's report must include any critical audit matters (CAMs) arising from the current period's audit of the financial statements, or state that the auditor determined that there were no CAMs. It is expected that, in most audits, the auditor would identify at least one CAM.

A critical audit matter is defined as a matter that was communicated or required to be communicated to the audit committee and that:

1. relates to accounts or disclosures that are material to the financial statements; and
2. involved especially challenging, subjective, or complex auditor judgment.

When determining whether a matter involved especially challenging, subjective, or complex auditor judgment, the auditor takes into account certain factors, including the auditor's assessment of the risks of material misstatement, areas of significant judgment or estimation by management, nature and timing of unusual transactions, the degree of subjectivity in applying audit procedures, and the extent of specialized skill or knowledge regarding a matter.

### 2.1.3 Reporting Language if CAMs Are Identified

The following language, including the section title "Critical Audit Matters," should precede critical audit matters communicated in the auditor's report:

**Critical Audit Matters**

The critical audit matters communicated below are matters arising from the current period audit of the financial statements that were communicated or required to be communicated to the audit committee and that: (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

[*Include critical audit matters*]

For each CAM identified, the audit report should include:

- **identification** of the CAM;
- description of the **principal** considerations that led the auditor to determine that the matter was a CAM;
- description of how the CAM was **addressed** in the audit; and
- reference to the relevant financial statement accounts or **disclosures**.



**Pass Key**

For each CAM, make sure you **Identify** it on a **PAD** of paper.

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### 2.1.4 Reporting Language if No CAMs Are Identified

In situations in which the auditor determines that there are no critical audit matters, the auditor should include the following language, including the section title "Critical Audit Matters," in the auditor's report:

> **Critical Audit Matters**
>
> Critical audit matters are matters arising from the current period audit of the financial statements that were communicated or required to be communicated to the audit committee and that: (1) relate to accounts or disclosures that are material to the financial statements and (2) involved our especially challenging, subjective, or complex judgments. We determined that there are no critical audit matters.

### 2.1.5 Other Reporting Requirements for CAMs

- Language that could be viewed as disclaiming, qualifying, restricting, or minimizing the auditor's responsibility for the critical audit matters or the auditor's opinion on the financial statements is not appropriate and may not be used.
- When describing critical audit matters in the auditor's report, the auditor is not expected to provide information about the company that has not been made publicly available by the company unless such information is necessary to describe the principal considerations that led the auditor to determine that a matter is a critical audit matter or how the matter was addressed in the audit.
- When the current period's financial statements are presented on a comparative basis with those of one or more prior periods, the auditor *may* communicate critical audit matters relating to a prior period. This may be appropriate, for example, when (1) the prior period's financial statements are made public for the first time, such as in an initial public offering, or (2) issuing an auditor's report on the prior period's financial statements because the previously issued auditor's report could no longer be relied upon.
- Communication of critical audit matters is not required for audits of (1) brokers and dealers reporting under Exchange Act Rule 17a-5; (2) investment companies registered under the Investment Company Act of 1940 ("Investment Company Act"), other than companies that have elected to be regulated as business development companies; (3) employee stock purchase, savings, and similar plans; and (4) emerging growth companies.

### 2.1.6 Documentation of CAMs

For each matter arising from the audit of the financial statements that:

**1.** was communicated or required to be communicated to the audit committee; and

**2.** relates to accounts or disclosures that are material to the financial statements,

the auditor must document whether the matter was determined to be a CAM and the basis for such determination.


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