NOTE: Text that should be deleted is displayed with a line through it. New text is shown with a blue background.

Your AUD materials have undergone extensive changes due to pronouncements that become testable on July 1, 2018. Please see below for a summary of the major changes, and then use the rest of this PDF to update the relevant pages in your book. These pages include the changes for outlines and questions.

Study Unit 9, Subunit 3, includes changes to reflect the new audit report format in PCAOB AS 3101, *The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*.

Study Unit 15 was revised to reflect the new PCAOB AS 3101, *The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, and AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*.

Study Unit 16 was revised to reflect the new PCAOB AS 3101, *The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, and AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*.

Study Unit 17 was revised to reflect SAS 133 (AU-C 945, *Auditor Involvement With Exempt Offering Documents*).

Appendix A was edited to update the listings for PCAOB AS 3101 and AS 3105 and to reflect SAS 133 (AU-C 945).

**Study Unit 9 – Internal Control Communications and Reports**

Pages 201-202, Subunit 9.3, Item 22.:  

22. **Examples of Reports on an Entity’s Internal Control**

a. **Below Following** is an audit report expressing an unmodified opinion of the effectiveness of ICFR for nonissuers (private entities). The differences from the report on the next page include (1) the title, (2) use of paragraph headings, (3) identification of applicable standards, and (4) other minor wording changes. However, the essence of the report is the same. **The essence of the reports for issuers and nonissuers is the same.** But the PCAOB report presented on the next page varies in the following ways:

1) The title is different.
2) The addressees are the board of directors and shareholders.
3) The opinion paragraph is presented in the first section.
4) The report states that the audit was conducted in accordance with PCAOB standards.
5) The report states that the firm is required to be independent.
6) The report must be manually signed by the audit firm.
7) The tenure of the audit firm must be stated, beginning with the first year of consecutive service as the company’s auditor.

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**EXAMPLE -- AU-C-940 Auditor’s Unmodified Report on Internal Control (AICPA Standards)**

**Independent Auditor’s Report**

To the Board of Directors and Shareholders of Z Company:

**Report on Internal Control Over Financial Reporting**

We have audited Z Company’s internal control over financial reporting as of December 31, 20X1, based on Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) [or other appropriate criteria].

**Management’s Responsibility for Internal Control Over Financial Reporting**

Management is responsible for designing, implementing, and maintaining effective internal control over financial reporting and for its assessment about the effectiveness of internal control over financial reporting, included in the accompanying [title of management’s report].

**Auditor’s Responsibility**

Our responsibility is to express an opinion on the entity’s internal control over financial reporting based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

An audit of internal control over financial reporting involves performing procedures to obtain audit evidence about whether a material weakness exists. The procedures selected depend on the auditor’s judgment, including the assessment of the risks that a material weakness exists. An audit includes obtaining an understanding of internal control over financial reporting and testing and evaluating the design and operating effectiveness of internal control over financial reporting based on the assessed risk.

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

**Definition and Inherent Limitations of Internal Control Over Financial Reporting**

An entity’s internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America [or other applicable financial reporting framework]. An entity’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction, of unauthorized acquisition, use, or disposition of the entity’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements. Also, projections of any assessment of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

**Opinion**

In our opinion, Z Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 20X1, based on Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

**Report on Financial Statements**

We also have audited, in accordance with auditing standards generally accepted in the United States of America, the [identify financial statements] of Z Company, and our report dated [date of report, which should be the same as the date of the report on the audit of ICFR] expressed an unmodified opinion.

Auditor’s Signature or Printed Name
Auditor’s City and State
Date

[...]
Report of the Independent Registered Public Accounting Firm

To The Board of Directors and Shareholders of W Company:

Opinion on Internal Control over Financial Reporting

We have audited W Company’s internal control over financial reporting as of December 31, 20X1, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) [or other appropriate criteria].

In our opinion, W Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 20X1, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the [identify financial statements] of W Company and our report dated [date of report, which should be the same as the date of the report on the effectiveness of internal control over financial reporting] expressed an unmodified opinion.

Basis for Opinion

W Company’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management’s Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the effectiveness of the company’s internal control over financial reporting based on our audit. 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 W 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 audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management’s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, W Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 20X1, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the [identify financial statements] of W Company and our report dated [date of report, which should be the same as the date of the report on the effectiveness of internal control over financial reporting] expressed an unmodified opinion.

Auditor’s Signature
We have served as W Company’s auditor since XXXX
Auditor’s City and State or Country
Date
Study Unit 15 – Reports -- Opinions and Disclaimers

Page 317, Introduction:

This study unit presents interrelated reporting issues. Subunit 15.2 should be studied carefully. Most reporting guidance is based on the auditor’s report expressing an unmodified opinion on financial statements. (The PCAOB uses the term “unqualified opinion.”) The other subunits of this study unit and all of Study Unit 16 outline the requirements for wording changes in the auditor’s report. Special reporting considerations (Study Unit 17), many matters considered in Study Units 18 and 19, and governmental audit reports (Study Unit 20) are variations of the auditor’s report.

Page 318, Subunit 15.1, Item 3.:

3. Form of Opinion

a. The auditor should express an unmodified (unqualified) opinion when (s)he concludes that the statements are presented fairly, in all material respects, in accordance with the framework.

b. If the auditor concludes that the statements are not fairly presented, (s)he should discuss the matter with management. Depending on how the matter is resolved, the auditor should determine whether the opinion should be modified.

c. A modified opinion is a qualified opinion, an adverse opinion, or a disclaimer of opinion. The opinion is modified if the auditor

1) Concludes that, based on the audit evidence obtained, the financial statements as a whole are materially misstated (qualified or adverse opinion) or

2) Is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement (qualified opinion or disclaimer of opinion).

Pages 319-323, Subunit 15.2:

15.2 THE AUDITOR’S REPORT

The AICPA’s Clarified Auditing Standards change the format of the auditor’s report for nonissuers. However, the PCAOB’s Auditing Standards continue to use a form for issuers based on prior AICPA standards. The basic difference is that the AICPA’s new format uses headings for all the sections of the report other than the introductory paragraph. The basic content of the report is the same based on both AICPA and PCAOB standards. Any specific differences are noted in the subsequent materials presented here.

The AICPA’s reporting standards define the format of the standard auditor’s report for nonissuers (nonpublic entities). It presents the auditor’s opinion in the final section of the report. However, the recently released PCAOB reporting standards for issuers (public companies) describe a different format. They present the opinion as the first section of the report. But the essence of the reports is the same.
We recommend that you learn as much about the auditor’s reports as you can. You will not be required to
draft a report on the exam, but questions often relate to how a report may change based on audit
findings. Having a firm grasp of the reports will serve you well.

1. The report for an audit of a nonissuer in accordance with GAAS (AICPA standards) should
include the following:

[ . . . ]

e. **Auditor’s responsibility.** This section should

1) State that the responsibility of the auditor is to express an opinion on the financial
statements based on the audit.

2) State that the audit was conducted in accordance with auditing standards generally
accepted in the United States of America. (The PCAOB’s report for an issuer
refers to “the standards of the Public Company Accounting Oversight Board,” not
GAAS.)

3) Explain that those standards require that the auditor plan and perform the audit to
obtain reasonable assurance about whether the statements are free from material
misstatement.

[ . . . ]

i. **Date of the auditor’s report.** The report should be dated no earlier than the date on
which the auditor has obtained sufficient appropriate audit evidence on which to base
the opinion, including evidence that The auditor should include the report date.
(Subunit 15.3 covers dating the report.)

   1) The audit documentation has been reviewed;
   2) All of the financial statements, including the related notes, have been prepared; and
   3) Management has asserted its responsibility for those statements.

[ . . . ]

3. **Example of an Auditor’s Report for a Nonissuer (AICPA Standards)**

   a. The following is an auditor’s report on consolidated comparative financial statements
prepared in accordance with U.S. GAAP. The report expresses an unmodified opinion
for all years presented. (If only single-year financial statements are presented, the
report is adjusted to refer only to those statements.)

   **EXAMPLE** -- Auditor’s Unmodified Report for a Nonissuer (AICPA Standards)

   Independent Auditor’s Report

   To:________________ Addressed to the Board of Directors and/or Shareholders

   [ . . . ]

4. **The report for an audit in accordance with PCAOB standards.** The following are the basic
elements of the unqualified report for an audit of the financial statements of an issuer in
accordance with PCAOB standards:

   a. The auditor’s report identifies the financial statements audited in an opening
(introductory) paragraph, describes the nature of an audit in a scope paragraph, and
expresses the auditor’s opinion in a separate opinion paragraph. **Title.** The title must
be, “Report of Independent Registered Public Accounting Firm,”

   b. The three paragraphs have no headings. **Addressee.** The addressees are the
shareholders and the board of directors (or equivalents for noncorporate entities).
Other addressees may be added.
c. The scope paragraph includes the statement “We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States)” rather than referring to “auditing standards generally accepted in the United States of America.” The first section of the report must be titled, “Opinion on the Financial Statements.” This section should

1) Identify the entity audited.
2) State that the statements have been audited.
3) Identify each statement (and any related schedules).
4) Specify the date or period covered by each statement.
5) Express an opinion that the statements present fairly, in all material respects, in conformity with the applicable financial reporting framework. The opinion also should identify the reporting framework (typically U.S. GAAP).

d. The report would also refer to the audit of internal control for an integrated audit if a separate report on internal control is not presented (See Study Unit 9, Subunit 3). The second section of the report must be titled, “Basis for Opinion.” This section should state the following:

1) The statements are the responsibility of the company’s management.
2) The auditor’s responsibility is to express an opinion on the statements based on the audit.
3) The audit was conducted in accordance with PCAOB standards.
4) PCAOB standards require the auditor to plan and perform the audit to obtain reasonable assurance about whether the statements are free of material misstatement, whether due to error or fraud;
5) The audit included (a) performing procedures to assess the risks of material misstatement, whether due to error or fraud, and performing procedures that respond to those risks; (b) examining, on a test basis, evidence regarding the amounts and disclosures in the statements; (c) evaluating the accounting principles used and significant estimates made by management; and (d) evaluating the overall presentation.
6) The auditor believes that the audit provides a reasonable basis for the opinion.
7) 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 U.S. federal securities laws and the applicable rules and regulations of the SEC and the PCAOB.

e. The following is an auditor’s report on consolidated comparative financial statements prepared in accordance with U.S. GAAP based on an audit using PCAOB standards. The report expresses an unmodified opinion for the years presented. (If only single-year financial statements are presented, the report is adjusted to refer only to those statements.) Signature of the auditor. The report should include the manual signature of the auditor’s firm.

f. Tenure. The report should state the first year of the auditor’s consecutive service as the company’s auditor.

g. Auditor’s address. The report should name the city and state (or city and country, in the case of non-U.S. auditors) from which the auditor’s report has been issued.

h. Date. The auditor should include the report date. (Subunit 15.3 covers dating the report.)

NOTE: The PCAOB requires audit firms to file Form AP (audit participants) disclosing (1) the name of the engagement partner and (2) information about other firms involved in the audit. This information may be included in the auditor’s report as well.
5. Example of an Auditor’s Report for an Issuer (PCAOB Standards)

a. The auditor’s report below is on consolidated comparative financial statements prepared in accordance with U.S. GAAP. It is based on an audit using PCAOB standards. The report expresses an unqualified opinion for all the years presented. (If only single-year financial statements are presented, the report is adjusted to refer only to those.)

---

**EXAMPLE -- Auditor’s Unmodified Unqualified Report for an Issuer (PCAOB Standards)**

Report of Independent Registered Public Accounting Firm

To: ________   Addressed to the Board of Directors and/or Shareholders of X Company

Opinion on the Financial Statements

We have audited the accompanying balance sheets of X Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, comprehensive income, stockholders’ equity, and cash flows, for the years then ended, and the related notes (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 each of the years in the period ended December 31, 20X2, 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 Public Company Accounting Oversight Board (United States) 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. An Our audit includes 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 include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. An Our audit also includes evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Y 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.

Auditor’s signature <--------- May be manual or printed The signature of the auditor’s firm
Auditor’s tenure <------------ We have served as the Company’s auditor since XXXX.
Auditor’s address <----------- City and state
Date <----------------------- No earlier than the date that sufficient appropriate audit evidence was obtained

b. The following is added to the opinion paragraph if internal control also was audited:

---

f. The PCAOB requires audit firms to file Form AP (1) disclosing the name of the engagement partner and (2) information about other firms involved in the audit.

6. Other Reporting Responsibilities (AICPA Standards)

[...]

7. Overview of Opinions

a. An unmodified (unqualified) opinion is the conclusion that the financial statements are presented fairly, in all material respects, in accordance with the framework.

[...]

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8. The auditor may choose to include, or be required to include, an *emphasis-of-matter* or *other-matter* paragraph in the auditor’s report for a nonissuer or an explanatory paragraph in the auditor’s report for an issuer.

a. An auditor of an issuer is permitted but **never** required to include an emphasis paragraph.

b. The matters addressed do not affect the type of opinion expressed. This subject is discussed in further detail in Study Unit 16 contains a detailed treatment of this subject.

9. **Summary of Modified Opinions**

Page 324, Subunit 15.3:

**15.3 ADDRESSING AND DATING THE REPORT**

1. **Addressing the Auditor’s Report**

a. **AICPA Standards (nonissuers).** The auditor’s report should be addressed to those for whom the report is prepared. It may be addressed to the entity whose statements are being audited or to those charged with governance. If the client is an unincorporated entity, the report should be addressed as circumstances dictate, e.g., to the partners or the proprietor.

   1) If an auditor is retained to audit the financial statements of an entity that is **not the client**, the report customarily is addressed to the client and not to those charged with governance. For example, if a bank engages an auditor to audit a loan applicant, the report is addressed to the bank.

b. **PCAOB Standards (issuers).** The auditor’s report **must** be addressed to the shareholders and the board of directors (or equivalents for noncorporate entities). Other addressees may be added.

2. **The Date of the Auditor’s Report**

Page 325, Subunit 15.4, Item 2.:

2. Financial statements may be fairly presented **except for** the effects or possible effects of a certain matter. If the opinion is qualified because of such effects, the auditor should describe the matter(s) resulting in the qualification.

a. **AICPA Standards (nonissuers).** This description is included in a “**Basis for Qualified Opinion**” paragraph **preceding the opinion** paragraph.

b. **PCAOB Standards (issuers).** This description is included in one or more separate paragraphs immediately **following the opinion** in the section titled, “**Opinion on the Financial Statements.**”

   1) Thus, no basis-for-modification title is required.
The opinion paragraph should contain qualifying language and refer to the basis for qualified opinion paragraph.

1) The opinion paragraph should include the words “except for.”
2) “Subject to,” “with the foregoing explanation,” and similar phrases lack clarity and forcefulness and should not be used.
3) Notes are part of the statements, and language such as “fairly presented when read in conjunction with Note 1” should not be used because of the likelihood of misunderstanding.

Page 326, Subunit 15.4, Items 3.f.-3.g.:

f. **AICPA Standards (nonissuers).** The following are the effects on the auditor’s report when the opinion is qualified due to an inability to obtain sufficient appropriate evidence with possible effects that are material but not pervasive:

1) The introductory paragraph is unchanged.
2) The management’s responsibility paragraph is unchanged.
3) The auditor’s responsibility section ends with the sentence, “We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.”

4) The following are examples of the basis for qualified opinion and opinion paragraphs:

```plaintext
EXAMPLE -- Opinion Qualified for a Material but Not Pervasive Scope Limitation (AICPA Standards)
[ . . . ]
```

g. **PCAOB Standards (issuers).** The report uses the PCAOB’s basic format (the basic elements of the report are presented in item 4. in Subunit 15.2). The “except for” qualified opinion is in the first section (“Opinion on the Financial Statements”), and the description of the scope limitation follows the opinion in the same section.

Page 327, Subunit 15.4, Items 5.c.-5.d.:

c. **AICPA Standards (nonissuers).** The following are the effects on the auditor’s report when the opinion is qualified due to a material but not pervasive misstatement:

1) The introductory paragraph is unchanged.
2) The management’s responsibility paragraph is unchanged.
3) The auditor’s responsibility section ends with the sentence, “We believe that the audit evidence we have obtained is sufficient and appropriate to provide a reasonable basis for our qualified audit opinion.”

4) The following are examples of the basis for qualified opinion and opinion paragraphs:

```plaintext
EXAMPLE -- Opinion Qualified for a Material but Not Pervasive Misstatement (AICPA Standards)
[ . . . ]
```

d. **PCAOB Standards (issuers).** The report uses the PCAOB’s basic format (the basic elements of the report are presented in item 4. in Subunit 15.2). The “except for” qualified opinion is in the first section (“Opinion on the Financial Statements”), and the description of the misstatement follows the opinion in the same section.
c. The following are the effects on the auditor’s report when the opinion is qualified due to inadequate disclosure:

1) The introductory paragraph is unchanged.
2) The management’s responsibility paragraph is unchanged.
3) The auditor’s responsibility section ends with the sentence, “We believe that the audit evidence we have obtained is sufficient and appropriate to provide a reasonable basis for our qualified audit opinion.”

d. The following are examples of the basis for qualified opinion and opinion paragraphs:

**EXAMPLE -- Opinion Qualified for Inadequate Disclosure (AICPA Standards)**

[...]

d. **PCAOB Standards (issuers).** The report uses the PCAOB’s basic format (the basic elements of the report are presented in item 4. in Subunit 15.2). The “except for” qualified opinion is in the first section (“Opinion on the Financial Statements”), and the description of the inadequate disclosure follows the opinion in the same section.

Pages 328-329, Subunit 15.5:

**15.5 ADVERSE OPINIONS**

1. The auditor should express an adverse opinion when, having obtained sufficient appropriate audit evidence, (s)he concludes that **misstatements**, individually or combined, are **material and pervasive** to the financial statements.

2. The auditor should include a **basis for adverse opinion** paragraph **preceding the opinion paragraph** that describes the matter resulting in the modification.

   a. If misstatements relate to specific amounts in the financial statements (including quantitative disclosures), the auditor should include a description and quantification of the financial effects, if practicable. If it is not practicable to quantify the financial effects, the auditor should so state.

3. The opinion should state that, because of the significance of the matter(s) described in the basis for adverse opinion paragraph, the financial statements are **not presented fairly** in accordance with the framework.

4. **Example of an Adverse Opinion Reports**

   a. The following are other effects on the auditor’s report when an adverse opinion is expressed:

      1) The introductory paragraph is unchanged.
      2) The management’s responsibility paragraph is unchanged.
      3) The auditor’s responsibility section is changed to state, “We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse audit opinion.”

   b. The following are examples of the basis for adverse opinion and opinion paragraphs:

**EXAMPLE -- Adverse Opinion Due to a Material and Pervasive Misstatement (AICPA Standards)**

[...]

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b. **PCAOB Standards (issuers).** The report uses the PCAOB’s basic format (the basic elements of the report are presented in item 4. in Subunit 15.2). The adverse opinion is in the first section (“Opinion on the Financial Statements”), and the description of the misstatement follows the opinion in the same section.

   1) Thus, no basis-for-modification title is required.

Pages 329-331, Subunit 15.6, Items 2.-6.:

2. The following are the effects on the auditor’s report when an opinion is disclaimed:

   a. The introductory first paragraph is changed to state, “We were engaged to audit . . .”

   b. The description of management’s responsibility paragraph is unchanged.

   c. Because an audit has not been conducted, the description of the auditor’s responsibility section is changed to consist only of (1) a one-sentence description of the auditor’s responsibility and (2) a statement that the auditor could not obtain sufficient appropriate audit evidence to express an opinion because of the matters described in the basis for disclaimer of opinion paragraph.

3. d. **AICPA Standards (nonissuers).** The following is an example of a disclaimer of opinion:

```
EXAMPLE -- Disclaimer of Opinion (AICPA Standards)

Independent Auditor’s Report

To:         Addressed to the Board of Directors or Shareholders

[ . . ]
```

---

e. **PCAOB Standards (issuers).** The report omits the items in the basis for opinion paragraph (except the first and last elements in item 4.d. in Subunit 15.2). The section titles are those in the following example of a disclaimer of opinion:

```
EXAMPLE -- Disclaimer of Opinion (PCAOB Standards)

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of X Company

Disclaimer of Opinion on the Financial Statements

We were engaged to audit the accompanying balance sheets of X Company (the “Company”) as of December 31, 20X2, and the related statements of income, comprehensive income, stockholders’ equity, and cash flows and the related notes (collectively referred to as the “financial statements”). As described in the following paragraph, because the Company did not take physical inventories and we were not able to apply other auditing procedures to satisfy ourselves as to inventory quantities and the cost of property and equipment, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements. We do not express an opinion on these financial statements.

The Company did not make a count of its physical inventory in 20X2 stated in the accompanying financial statements at $______ as of December 31, 20X2. Further, evidence supporting the cost of property and equipment acquired prior to January 1, 20X2, is no longer available. The Company’s records do not permit the application of other auditing procedures to inventories or property and equipment.

Basis for Disclaimer of Opinion

These financial statements are the responsibility of the Company’s management. 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.

Auditor’s signature <---------- The signature of the auditor’s firm
Auditor’s tenure <---------- We have served as the Company’s auditor since XXXX.
Auditor’s address <---------- City and state
Date <---------------------- No earlier than the date that sufficient appropriate audit evidence was obtained
```
4. Auditor Not Independent but Required to Report

[...]

4. Reporting on a Single Financial Statement

a. The auditor may, in appropriate circumstances, express an unmodified opinion on one basic financial statement (e.g., the balance sheet). References in the introductory and opinion paragraphs of the report are made only to the one statement. The other sections of the report are essentially unaffected.

[...]

5. Accountant Associated with the Unaudited Financial Statements of an Issuer

[...]

d. Accountants providing nonaudit services to **nonissuers** should follow the guidance in **Statements on Standards for Accounting and Review Services or Statements on Standards for Attestation Engagements**. (These matters are covered in detail in Study Units 18 and 19, respectively.)

Page 336, Subunit 15.5, Questions 13 and 14:

13. An auditor’s report in an audit of a nonissuer includes the following statement: “The financial statements referred to above do not present fairly the financial position, results of operations, or cash flows in conformity with U.S. generally accepted accounting principles.” This auditor’s report was most likely issued in connection with financial statements that are

A. Inconsistent.
B. Based on prospective financial information.
C. Misleading.
D. Affected by a material uncertainty.

Answer (C) is correct.

**REQUIRED:** The nature of the financial statements on which the quoted report was issued.

**DISCUSSION:** The language quoted states an adverse opinion. The essence of an adverse opinion is that the statements reported on, as a whole, are materially and pervasively misstated. If financial statements fail to meet the standards, they are misleading.

Answer (A) is incorrect. An inconsistency, by itself, results in no modification of the opinion paragraph. Answer (B) is incorrect. The accountant’s examination report on a financial forecast or projection refers to guidelines for the presentation of a forecast (or projection) established by the AICPA, not to U.S. GAAP (AT-C 305). Answer (D) is incorrect. A material uncertainty, if properly disclosed, does not require modification of the opinion.

14. When an auditor expresses an adverse opinion, the opinion paragraph should include

A. The effects of the material misstatement.
B. A direct reference to a separate paragraph disclosing the basis for the opinion.
C. The financial effects of the misstatement.
D. A description of the uncertainty or scope limitation that prevents an unmodified opinion.

Answer (B) is correct.

**REQUIRED:** The matter included in the opinion paragraph when an adverse opinion is expressed.

**DISCUSSION:** An adverse opinion states that the financial statements are not fairly presented in accordance with the applicable financial reporting framework. When an adverse opinion is expressed, the opinion paragraph should directly refer to a basis for adverse opinion paragraph that discloses the basis for the adverse opinion. This paragraph should precede the opinion paragraph (AU-C 705).

Answer (A) is incorrect. The effects of the material misstatement, if practicable, should be stated in the basis for adverse opinion paragraph. Answer (C) is incorrect. The financial effects of the misstatement should be stated in the basis paragraph. Answer (D) is incorrect. An adverse opinion is not expressed as a result of an uncertainty or scope limitation.
Study Unit 16 – Reports -- Other Modifications

Page 339, Introduction:

This study unit covers additional language modifying the auditor’s report. These modifications normally do not affect the auditor’s opinion on the financial statements. They permit the users of the financial statements and readers of the auditor’s report to better understand the responsibility assumed by the auditor. They also provide information about the client’s financial statements that the auditor considers important. The following table summarizes these modifications:

<table>
<thead>
<tr>
<th>Basis for Modifying the Report</th>
<th>Modification</th>
</tr>
</thead>
<tbody>
<tr>
<td>Group auditor’s report refers to the audit of the component auditor</td>
<td>Auditor’s responsibility section-and-opinion paragraph</td>
</tr>
<tr>
<td>Material accounting change affects consistency</td>
<td>Emphasis-of-matter paragraph</td>
</tr>
<tr>
<td>Substantial going-concern doubt</td>
<td>Emphasis-of-matter paragraph</td>
</tr>
<tr>
<td>Prior-period opinion changed in comparative statements</td>
<td>Emphasis-of-matter paragraph or other-matter paragraph</td>
</tr>
<tr>
<td>Predecessor auditor’s report not presented in comparative statements</td>
<td>Other-matter paragraph</td>
</tr>
<tr>
<td>Drawing attention to matter presented or not-presented</td>
<td>Emphasis-of-matter paragraph or other-matter paragraph, respectively</td>
</tr>
</tbody>
</table>

A candidate who is unfamiliar with the AICPA’s use of emphasis-of-matter or other-matter paragraphs may want to should study Subunit 16.5 before proceeding.

Page 342, Subunit 16.1, Item 4.c.:

c. The component auditor’s report may include (1) a modified opinion, (2) an emphasis-of-matter paragraph, or (3) an other matter or an additional paragraph that does not affect the report on the group statements. If the component auditor’s report is not presented, the group auditor need not refer to those paragraphs issues in the auditor’s report.

Page 343, Subunit 16.1, Item 5.:

5. Report Making Reference

a. The following is an example of the two paragraphs from the auditor’s report that are changed by the reference to a component auditor. The description of other auditors in AICPA and PCAOB reports is substantively the same. The only difference in the reports is the location of the information. The AICPA report includes the information in the “Auditor’s Responsibility” section and the “Opinion” section. The PCAOB includes the information in the “Opinion on the Financial Statements” and the “Basis for Opinion” sections.
b. The following is an example from an AICPA report:

<table>
<thead>
<tr>
<th>EXAMPLE -- Reference to a Component Auditor (AICPA Standards)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Auditor’s Responsibility</strong></td>
</tr>
<tr>
<td>Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of B Company, a wholly-owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.</td>
</tr>
<tr>
<td><strong>Opinion</strong></td>
</tr>
<tr>
<td>In our opinion, based on our audit and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ABC Company 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.</td>
</tr>
</tbody>
</table>

[The remainder of the Auditor’s Responsibility section is and other sections of the report are unchanged.]

<table>
<thead>
<tr>
<th>Opinion</th>
</tr>
</thead>
<tbody>
<tr>
<td>In our opinion, based on our audit and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ABC Company 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.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Basis for Opinion</th>
</tr>
</thead>
<tbody>
<tr>
<td>We believe that our audit and the report of the other auditors provide a reasonable basis for our opinion.</td>
</tr>
</tbody>
</table>


c. The following is an example from a PCAOB report:

<table>
<thead>
<tr>
<th>EXAMPLE -- Reference to a Component Auditor (PCAOB Standards)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Opinion on the Financial Statements</strong></td>
</tr>
<tr>
<td>We have audited the accompanying consolidated balance sheet of X Company (the &quot;Company&quot;) and subsidiaries as of December 31, 20X1, and the related consolidated statements of [titles of the financial statements, e.g., income, comprehensive income, stockholders' equity, and cash flows] for the year then ended, and the related notes [and schedules] (collectively referred to as the &quot;consolidated financial statements&quot;). In our opinion, based on our audit and the report of the other auditors, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of [at] December 31, 20X1, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. We did not audit the financial statements of B Company, a wholly-owned subsidiary, which statements reflect total assets and revenues constituting 20 percent and 22 percent, respectively, of the related consolidated totals. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of the other auditors.</td>
</tr>
<tr>
<td><strong>Basis for Opinion</strong></td>
</tr>
<tr>
<td>[The Basis for Opinion section is unchanged except for the last sentence.]</td>
</tr>
<tr>
<td>We believe that our audit and the report of the other auditors provide a reasonable basis for our opinion.</td>
</tr>
</tbody>
</table>

Page 344, Subunit 16.2, Item 2.f.:

f. If the criteria stated in 2.d. above are met, and the change in principle is material, the auditor of a nonissuer should is required to include an emphasis-of-matter paragraph in the report. (In an audit of an issuer, an explanatory paragraph is required.) This paragraph

1. Describes the change,
2. Refers to the entity’s disclosures, and
3. Follows the opinion paragraph.
5. Example of Reporting on the Change in Accounting Principle
   a. The following is an emphasis-of-matter paragraph that follows an opinion paragraph for a change in principle.

   **EXAMPLE -- Paragraph Added to Auditor’s Report for a Change in Principle (AICPA Standards)**

   **Emphasis of Matter**
   As discussed in Note X to the financial statements, the Company changed its method of computing depreciation in Year 3. Our opinion is not modified with respect to this matter.

   b. The PCAOB permits but never requires use of an emphasis paragraph with an appropriate section title. An example of what is permitted to be emphasized is an accounting matter not involving a change in principle. (But a change in depreciation method is a change in estimate inseparable from a change in principle.)

      1) The PCAOB requires inclusion of explanatory language (or a paragraph) for a material change in principle.

Page 346, Subunit 16.3, Item 2.:

2. Going-Concern Issues
   a. The auditor should evaluate whether substantial doubt exists about an entity’s ability to continue as a going concern for a reasonable period. (Under U.S. GAAP, this period is 1 year from the date the statements are issued or available to be issued.) An emphasis-of-matter paragraph should be added following the opinion paragraph if a substantial doubt exists. (The PCAOB requires inclusion of explanatory language or a paragraph for a going concern issue. An emphasis paragraph is permitted for some matters but never for a required inclusion.)

   [..]

   **EXAMPLE -- Paragraph Added to Auditor’s Report Expressing Substantial Doubt about Going Concern (AICPA Standards)**

   **Emphasis of Matter**
   The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency that raises substantial doubt about its ability to continue as a going concern. Management’s plans in regard to these matters are also described in Note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Pages 347-349, Subunit 16.4:

16.4 COMPARATIVE FINANCIAL STATEMENTS

1. General Considerations
   [..]

   d. The report applies to individual financial statements, so an auditor may (1) express a qualified or an adverse opinion, (2) disclaim an opinion, or (3) include an emphasis-of-matter or other-matter paragraph (explanatory language or paragraph in a PCAOB report) for one or more statements for one or more periods while issuing a different report on the other statements.

   [..]
3. **Opinion on Prior-Period Financial Statements Different from the Opinion Previously Issued Expressed**

   a. An auditor may become aware of circumstances or events affecting the statements of a prior period and should consider them when updating the report.

   1) For example, if the opinion was modified because of a material misstatement and the statements are revised in the current period, the updated report should express an unmodified opinion.

   2) An emphasis-of-matter or other-matter paragraph (explanatory language or paragraph in a PCAOB report) should disclose:
      a) All substantive reasons for the different opinion,
      b) The date of the previous report,
      c) The type of opinion previously expressed, and
      d) That the updated opinion differs from the previous opinion.

   3) The introductory paragraph, management’s responsibility paragraph, and auditor’s responsibility section are not modified in the updated report. The paragraph follows the opinion. But the other parts of the report are unchanged.

4. **Report of Predecessor Auditor**

   [. . .]

   d. In certain circumstances, a predecessor auditor’s report may not be reissued (e.g., because the CPA is no longer in public practice).

   1) When the predecessor auditor’s report is not presented, the auditor’s report should include an **other-matter** paragraph that states the following:

      a) The prior-period statements were audited by a predecessor auditor. (But the auditor should not name the predecessor auditor unless the predecessor’s practice was acquired by, or merged with, that of the auditor.)

      b) The date of the predecessor’s report.

      c) The type of opinion expressed by the predecessor and the reasons for any modification.

      d) The nature of any emphasis-of-matter or other-matter paragraph additional disclosures in the predecessor’s report.

   2) An auditor’s report when the predecessor’s report is not reissued includes an **other-matter** paragraph similar to the example that follows.

<table>
<thead>
<tr>
<th><strong>EXAMPLE -- Other-Matter Paragraph Added to Auditor’s Report to Reference Predecessor’s Report (AICPA Standards)</strong></th>
</tr>
</thead>
</table>

**Other Matter**
The financial statements of ABC Company as of December 31, Year 1, were audited by other auditors whose report dated March 31, Year 2, expressed an unmodified opinion on those statements.

3) If the predecessor’s report contained an emphasis of matter paragraph, the following is an example of an **other-matter** paragraph. A PCAOB report presents the same information in an unlabeled paragraph following the opinion in the first section of the report.

<table>
<thead>
<tr>
<th><strong>EXAMPLE -- Other-Matter Paragraph of Auditor’s Report to Reference Predecessor’s Modified Report</strong></th>
</tr>
</thead>
</table>

**Other Matter**
The financial statements of ABC Company as of December 31, Year 1, were audited by other auditors whose report on those statements, dated March 1, Year 2, included an emphasis-of-matter paragraph that described the change in the Company’s method of computing depreciation discussed in Note X to the financial statements.
4) The statements audited by a predecessor auditor whose report is not reissued may have been restated. An auditor who has audited the adjustments includes an other-matter paragraph indicating that a predecessor reported on them before restatement. Also, if the auditor becomes satisfied as to the propriety of the restatement, (s)he also may report on the restatement.

EXAMPLE—Other-Matter Paragraph of Auditor’s Report to Reference Prior Financial Statements that Have Been Restated

Other-Matter
(Paragraph stating information about the predecessor auditor’s report)

As part of our audit of the Year 2 financial statements, we also audited the adjustments described in Note X that were applied to restate the Year 1 financial statements. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the Year 1 financial statements of the Company other than with respect to the adjustments, and, accordingly, we do not express an opinion or any other form of assurance on the Year 1 financial statements as a whole.

5. Prior-Period Financial Statements Not Audited

a. Current-period statements of a nonissuer may be audited and presented in comparative form with compiled or reviewed financial statements for the prior period. If the report on the prior period is not reissued, the auditor should include an other-matter paragraph in the current-period auditor’s report that includes the following:

1) The service performed in the prior period
2) The date of the report on that service
3) A description of any material modifications noted in that report
4) A statement that the service was less in scope than an audit and does not provide a basis for the expression of an opinion on the financial statements

[. . .]

Page 349, Subunit 16.5, Background:

16.5 EMPHASIS-OF-MATTER AND OTHER-MATTER PARAGRAPHS (AICPA STANDARDS)

Background

Prior AICPA auditing standards referred to “emphasis-of-matter” and “other-matter” paragraphs as simply “explanatory paragraphs.” Current PCAOB auditing standards continue to use the term. The use and content of the paragraph is the same for both in the AICPA and the PCAOB reports, but the paragraph in the PCAOB audit report for issuers is not titled. However, the PCAOB standards exclude a title when the paragraph is presented in the “Opinion” section or indicates the paragraph should be appropriately titled in other cases.

Page 352, Subunit 16.1, Questions 2 and 3:

2. An auditor may issue an unmodified audit report when the

A. Auditor refers to the findings of an auditor’s specialist.
B. Financial statements are derived from audited financial statements but contain less detail.
C. Financial statements are prepared on the cash receipts and disbursements basis of accounting chosen by management.
D. Group engagement partner assumes responsibility for the work of a component auditor.

Answer (D) is correct. 

REQUIRED: The situation in which an auditor’s report may be unmodified.

DISCUSSION: If the group engagement partner assumes responsibility for the work of the component auditor, the component auditor is not referred to in the report on the group financial statements.

Answer (A) is incorrect. The auditor does not refer to an auditor’s specialist unless (s)he departs from an unmodified opinion. Answer (B) is incorrect. The report on summary financial statements varies in many respects, e.g., it identifies the summary financial statements and the audited financial statements. Answer (C) is incorrect. A modification of the report is appropriate. The cash basis generally is not an acceptable reporting framework to describe the special purpose framework.
3. In which of the following situations will a group auditor be most likely to refer to a component auditor who audited a subsidiary of the entity?

A. The component auditor performed an audit in accordance with PCAOB standards.
B. The component auditor issued a restricted use report.
C. The financial statements audited by the component auditor are prepared using a financial reporting framework different from that used in the group statements.
D. The component auditor is not independent.

Answer (A) is correct.

REQUIRED: The situation in which a group auditor is most likely to refer to a component auditor.

DISCUSSION: The group engagement partner may not refer to the audit of the component auditor unless the component auditor performed an audit in accordance with (1) GAAS or (2), if required by law or regulation, PCAOB auditing standards.

Answer (B) is incorrect. Reference to the audit of the component auditor is not made unless the component auditor has issued an unrestricted report. Answer (C) is incorrect. When the reporting frameworks differ, no reference is made unless certain conditions are met. Moreover, the group auditor’s report should disclose that responsibility is taken for evaluating the adjustments needed to convert from one framework to the other. Answer (D) is incorrect. When the component auditor is not independent or the group engagement team has serious concerns about other ethical issues or professional competence, no reference is made.

Pages 353-354, Subunit 16.2, Questions 4-7:

4. The following additional paragraph was included in an auditor’s report of a nonissuer to indicate a lack of consistency:

“As discussed in note T to the financial statements, the company changed its method of computing depreciation in Year 1.”

How should the auditor report on this matter if the auditor concurred with the change?

<table>
<thead>
<tr>
<th>Type of Opinion</th>
<th>Location of Additional Paragraph</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unmodified</td>
<td>Before Opinion paragraph</td>
</tr>
<tr>
<td>Qualified</td>
<td>After Opinion paragraph</td>
</tr>
</tbody>
</table>

Answer (B) is correct.

REQUIRED: The reporting of a lack of consistency.

DISCUSSION: A change in accounting principle meeting certain criteria and having a material effect on the financial statements of a nonissuer requires the auditor to refer to the change in an emphasis-of-matter paragraph of the report. This paragraph should follow the opinion paragraph, describe the change, and refer to the entity’s disclosure. If the report is for an issuer, the wording of the paragraph is unchanged. But it is included in explanatory language (or an explanatory paragraph). It is not included in an emphasis paragraph.
5. For which of the following events would an auditor issue a report that omits any reference to a change in accounting principle or correction of a material misstatement?

A. A change in the method of accounting for inventories.
B. A change from an accounting principle that is not in accordance with the applicable reporting framework to one that is.
C. A change in the useful life used to calculate the provision for depreciation expense.
D. Management's lack of reasonable justification for a material change in accounting principle.

Answer (C) is correct.

**REQUIRED:** The event not requiring a reference to a change in accounting principle or correction of a material misstatement in the auditor's report.

**DISCUSSION:** A change in estimate is neither a change in accounting principle nor the correction of a material misstatement in previously issued financial statements. Thus, it requires no modification of the opinion or other recognition in the report. However, an exception is a material change in estimate that is inseparable from a change in principle. The auditor evaluates and reports on this change as a change in principle.

Answer (A) is incorrect. A material change in the method of accounting for inventory, for example, from FIFO to LIFO, is a change in accounting principle. It requires an emphasis-of-matter separate paragraph in the auditor's report that describes the new accounting guidance. Answer (B) is incorrect. A correction of a material misstatement, e.g., a change from an accounting principle that is not in accordance with the applicable reporting framework to one that is, requires an emphasis-of-matter separate paragraph that includes a statement that previously issued statements have been restated to correct a material misstatement. Answer (D) is incorrect. Lack of justification for a material change in accounting principle requires the auditor to express a qualified or an adverse opinion. The basic form modification paragraph describes the matter.

6. When the auditor concurs with a change in accounting principle that materially affects the comparability of the comparative financial statements, the auditor should

<table>
<thead>
<tr>
<th>Concur Explicitly with the Change</th>
<th>Express a Qualified Opinion</th>
<th>Refer to the Change in an Additional Paragraph</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>B. Yes</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>C. Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>D. No</td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>

Answer (A) is correct.

**REQUIRED:** The appropriate report when the auditor concurs with a change in accounting principle.

**DISCUSSION:** A material change in accounting principle raises a consistency issue. Thus, a report with an emphasis-of-matter separate paragraph is required if the auditor’s evaluation concludes that certain criteria have been met: (1) the new principle and the method of accounting for it are in accordance with the applicable framework, (2) related disclosures are appropriate, and (3) the entity has justified that the principle is preferable. The opinion is modified for a material change in principle only if the criteria are not met. Furthermore, the auditor’s concurrence is implied by the inclusion of an emphasis-of-matter descriptive paragraph. This paragraph is included only if the opinion is not modified with regard to the matter.

7. When management does not provide reasonable justification for a change in accounting principle, and it presents comparative financial statements, the auditor should express a qualified opinion

A. Only in the year of the accounting principle change.
B. Each year that the financial statements initially reflecting the change are presented.
C. Each year until management changes back to the accounting principle formerly used.
D. Only if the change is to an accounting principle that is not generally accepted.

Answer (B) is correct.

**REQUIRED:** The year(s) or circumstance in which an unjustified accounting change requires a qualified opinion.

**DISCUSSION:** If (1) the new principle and the method of accounting for the effect of the change are in accordance with the applicable reporting framework, (2) disclosures are adequate, and (3) the entity has justified that the principle is preferable, the auditor expresses an unmodified opinion. Otherwise, if the change is material, the misstatement results in expression of a qualified or an adverse opinion in the report for the year of change. A basis for the modified opinion paragraph is added preceding included in the opinion paragraph report. In the period of the change, the auditor also must add an emphasis-of-matter additional paragraph following the opinion paragraph to reflect the inconsistency. This paragraph is required in reports on financial statements in the period of change and in subsequent periods until the new principle is applied in all periods presented.
8. An auditor most likely will express an unmodified opinion and will not add additional language to the report if the auditor

A. Wishes to emphasize that the entity had significant transactions with related parties.
B. Concurs with the entity’s change in its method of computing depreciation.
C. Discovers that supplementary information required by FASB has been omitted.
D. Believes that there is a remote likelihood of a material loss resulting from an uncertainty.

Answer (D) is correct.

**REQUIRED:** The condition under which an additional paragraph is not added to the report.

**DISCUSSION:** Normally, an uncertainty does not require the auditor to add a paragraph to the report.

Answer (A) is incorrect. Emphasis of a matter is accomplished with an additional paragraph added to the auditor’s report. Answer (B) is incorrect. A change in the depreciation method is a change in principle. If material, the change in principle requires an additional paragraph.

Answer (C) is incorrect. AU-C 730 Both AICPA and PCAOB standards require the auditor to add an other-matter additional paragraph when supplementary information that is required by FASB or GASB has been omitted.

9. Management believes, and the auditor is satisfied, that a material loss probably will occur when pending litigation is resolved. Management is unable to make a reasonable estimate of the amount or range of the potential loss but fully discloses the situation in the notes to the financial statements. If management does not make an accrual in the financial statements, the auditor should express a(n)

A. Qualified opinion due to a scope limitation.
B. Qualified opinion due to a material misstatement.
C. Unmodified opinion with an emphasis-of-matter additional paragraph.
D. Unmodified opinion with no additional paragraph in the auditor’s report.

Answer (D) is correct.

**REQUIRED:** The auditor’s reporting when a material loss is probable but not subject to estimation.

**DISCUSSION:** If the auditor concludes that sufficient appropriate evidence supports management’s assertions about the nature of a matter involving an uncertainty, an unmodified report is ordinarily appropriate.

Answer (A) is incorrect. Inability to make a reasonable estimate of the potential loss is not a scope limitation. Answer (B) is incorrect. No material misstatement exists, an accrual of the loss contingency is not required in these circumstances, and full disclosure has been made. Thus, no report modification should be made. Answer (C) is incorrect. No basis for including an emphasis-of-matter additional paragraph to the report is given.

10. When an auditor concludes that substantial doubt exists about an entity’s ability to continue as a going concern for a reasonable period of time, the auditor’s responsibility is to

A. Prepare prospective financial information to verify whether management’s plans can be effectively implemented.
B. Project future conditions and events for a period of time not to exceed 1 year following the date of the financial statements.
C. Express a qualified or adverse opinion, depending on materiality, because of the possible effects on the financial statements.
D. Consider the adequacy of disclosure about the entity’s possible inability to continue as a going concern.

Answer (D) is correct.

**REQUIRED:** The auditor’s responsibility given a substantial doubt about an entity’s ability to continue as a going concern.

**DISCUSSION:** If the auditor reaches this conclusion after (1) identifying conditions and events that create such doubt and (2) evaluating management’s plans to mitigate their effects, (s)he should consider the adequacy of disclosure and include an emphasis-of-matter additional paragraph (after the opinion paragraph) in the report that includes the words “substantial doubt” and “going concern.” If disclosure is inadequate, the material misstatement requires modification of the opinion. By itself, however, the substantial doubt does not require a modified opinion paragraph or a disclaimer of opinion.

Answer (A) is incorrect. The auditor should consider management’s plans but need not prepare prospective financial information. Answer (B) is incorrect. The auditor is not responsible for predicting future conditions or events. Answer (C) is incorrect. The opinion is not modified solely for a going-concern issue.
11. An auditor's report included the following paragraph relative to substantial doubt about a client's ability to continue as a going concern:

“The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. If the Company is not able to renew the contract described in Note X, there may be substantial doubt about the company's ability to continue as a going concern.”

Which of the following statements is true?

A. The paragraph should not refer to a note to the financial statements.
B. The report should not contain conditional language.
C. The report should refer to a qualification of the opinion.
D. The report should not use the phrase “substantial doubt.”

Answer (B) is correct.

REQUIRED: The true statement about a report addressing a client's ability to continue as a going concern.

DISCUSSION: The report should not contain conditional language. “If the Company is not able to renew the contract . . .” is not permissible language.

Answer (A) is incorrect. The report may refer to a note that describes the issues. Answer (C) is incorrect. The opinion should not be qualified for a going-concern doubt. Rather, an emphasis-of-matter additional paragraph should be included in the report. Answer (D) is incorrect. The report should include the phrases “substantial doubt” and “going concern.”

12. Green, CPA, is auditing JKL Co., a nonissuer. Green concludes that there is substantial doubt about JKL Co.'s ability to continue as a going concern. If JKL’s financial statements adequately disclose its financial difficulties, Green’s auditor’s report should

Include a Paragraph Following the Opinion Paragraph

<table>
<thead>
<tr>
<th></th>
<th>Specifically Use the Words “Going Concern”</th>
<th>Specifically Use the Words “Substantial Doubt”</th>
</tr>
</thead>
<tbody>
<tr>
<td>A.</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>B.</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>C.</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>D.</td>
<td>No</td>
<td>Yes</td>
</tr>
</tbody>
</table>

Answer (A) is correct.

REQUIRED: The effect of a substantial doubt about the going-concern assumption.

DISCUSSION: An evaluation should be made as to whether substantial doubt exists about the entity’s ability to continue as a going concern for a reasonable period of time (U.S. GAAP is 1 year from the date the statements are released or available to be released). If the auditor reaches this conclusion after identifying conditions and events that create such doubt and after evaluating management’s plans to reduce their effects, (s)he should consider the possible effects on the statements and the adequacy of disclosure. (S)he also should include an emphasis-of-matter paragraph (after the opinion paragraph) in the report. The auditor should use language in the emphasis-of-matter paragraph that includes the phrases “substantial doubt” and “going concern.” Also, the emphasis-of-matter paragraph should not use conditional language in expressing its conclusion about the existence of a substantial doubt. The substantial doubt is not a basis for a qualified or an adverse opinion, but a disclaimer is not precluded in the case of such a material uncertainty.
Page 356, Subunit 16.4, Questions 14 and 15:

14. When reporting on comparative financial statements of a nonissuer, an auditor ordinarily should change the previously expressed opinion on the prior year’s financial statements if the

A. Prior year’s financial statements are restated to correct a material misstatement.
B. Auditor is a predecessor auditor who has been requested by a former client to reissue the previously issued report.
C. Prior year’s opinion was unmodified and the opinion on the current year’s financial statements is modified due to a change in accounting principle.
D. Reporting entity has changed as a result of the sale of a subsidiary.

Answer (A) is correct.

REQUIRED: The event that causes an auditor to change a previously expressed opinion.

DISCUSSION: If the previous opinion was modified because of a material misstatement, but the prior year’s statements were restated to remove the basis for the modification, the updated report should express an unmodified opinion. The auditor’s report should include an emphasis-of-matter paragraph that (1) states that the previously issued financial statements have been restated to correct a material misstatement and (2) refers to the entity’s disclosure (AU-C 708).

Answer (B) is incorrect. If the predecessor’s report is still appropriate, it normally should be reissued without revision. Answer (C) is incorrect. A change in accounting principle in the current period has no effect on the opinion expressed in the prior year. Answer (D) is incorrect. A change in the reporting entity resulting from a transaction or event, for example, a purchase or disposition of a subsidiary, does not require recognition in the auditor’s report. Furthermore, such a transaction or event in the current year is not a circumstance that affects the prior period’s statements. Thus, it presents no basis for modifying the opinion expressed on those statements.

15. Jewel, CPA, audited Infinite Co.’s prior-year financial statements (Infinite Co. is a nonissuer). These statements are presented with those of the current year for comparative purposes without Jewel’s auditor’s report, which expressed a qualified opinion. In drafting the current year’s auditor’s report, the current auditor should

I. Not name Jewel as the predecessor auditor
II. Indicate the type of opinion expressed by Jewel
III. Indicate the reasons for Jewel’s qualification

A. I only.
B. I and II only.
C. II and III only.
D. I, II, and III.

Answer (D) is correct.

REQUIRED: The matter(s) included in an auditor’s report.

DISCUSSION: The auditor should state in an other-matter paragraph (following the opinion paragraph and any emphasis-of-matter paragraph) (1) that the prior year’s financial statements were audited by another auditor, (2) the date of the report, (3) the type of opinion expressed and the reasons for any modification, and (4) the nature of any emphasis-of-matter or other-matter paragraph. Furthermore, the predecessor auditor is not named.
Page 357, Subunit 16.5, Questions 17 and 18:

17. An other-matter paragraph is included in the auditor’s report of a nonissuer except when
A. The opinion on the prior-period statements has changed.
B. Required supplementary information is presented.
C. A predecessor auditor’s report is not reissued.
D. The client has materially restated the prior year’s comparative financial statements.

Answer (D) is correct.

REQUIRED: The purpose for which an other-matter paragraph is inappropriate.

DISCUSSION: An other-matter paragraph draws attention to a matter not required to be presented or disclosed in the financial statements that is relevant to users’ understanding of the auditor’s audit, responsibilities, or report. A correction of a material misstatement in previously issued financial statements requires the auditor to include an emphasis-of-matter paragraph. This matter is appropriately presented or disclosed in the financial statements and is fundamental to users’ understanding.

Answer (A) is incorrect. An auditor’s opinion on prior-period statements reported on in connection with the current audit may have changed. If so, the auditor should make certain disclosures in an emphasis-of-matter or other-matter paragraph.

Answer (B) is incorrect. An auditor should include an other-matter paragraph in the auditor’s report to refer to the presentation of required supplementary information.

Answer (C) is incorrect. The auditor should include an other-matter paragraph in the auditor’s report when prior-period statements presented comparatively with the current period’s statements were audited by a predecessor auditor whose report is not reissued.

18. In which situation is the auditor most likely not to include an emphasis-of-matter paragraph in the auditor’s report of a nonissuer?
A. An important audit procedure was performed.
B. The client suffered a major catastrophe.
C. Significant transactions with related parties were recorded.
D. Unusually important subsequent events occurred.

Answer (A) is correct.

REQUIRED: The situation in which an emphasis-of-matter paragraph is not included in the auditor’s report.

DISCUSSION: An emphasis-of-matter paragraph is not used to describe an audit procedure. It is used to draw attention to a matter appropriately presented or disclosed in the financial statements that is fundamental to users’ understanding. The following are examples of circumstances in which the auditor may need to include an emphasis-of-matter paragraph:
1. an uncertainty relating to the future outcome of unusually important litigation or regulatory action;
2. a major catastrophe that has had, or continues to have, a significant effect on the entity’s financial position;
3. significant transactions with related parties; and
4. unusually important subsequent events.

Study Unit 17 – Related Reporting Topics

Pages 367, Subunit 17.3, New Item 3.: 3. Auditor Involvement With Exempt Offering Documents

As in the case of securities filed under SEC rules, additional duties and responsibilities may accrue to the auditor if it is “involved” with an “exempt offering.” The auditor performs similar types of procedures in both cases.

a. Certain securities offerings and franchise offerings may be sold under conditions other than through an SEC registered offering (e.g., private placements, government-backed securities, and franchise offerings).

1) Auditors (and reviewers of interim financial information) may have reports included in an exempt offering document.
2) If the report is included and the auditor has performed **additional activities** relative to the exempt offering, the auditor is deemed “involved.” Additional procedures should be performed leading up to the distribution, circulation, or submission of the exempt offering document. The activities that involve the auditor include:
   (a) assisting preparation or reading a draft of the offering document, (b) issuing a comfort letter or participating in due diligence discussions relating to the offering document, (c) issuing an attestation report on related information, or (d) agreeing in writing to the use of the report in the offering document.

b. Additional required procedures leading up to the distribution, circulation, or submission of the exempt document include:
   1) Reading the “other information.” (This component can be found in Subunit 17.4.)
   2) Performing subsequent events procedures with appropriate follow up. (This component can be found in Subunit 13.2.)
   3) Obtaining an updated representation letter.

c. A predecessor auditor whose comparative report is included in the exempt offering should take the appropriate steps to ensure his or her report is still appropriate.

Appendix A – Auditing Authoritative Pronouncements Cross-References

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