



# New AICPA Auditor's Report

1

## SAS 134

### **SAS 134, Auditor Reporting and Amendments, Including Addressing Disclosures in the Audit of Financial Statements**

- Issued May 2019

#### Impacts:

- AU-C 700, Forming an Opinion and Reporting on Financial Statements
- AU-C 701, Communicating Key Audit Matters in the Independent Auditor's Report
- AU-C 705, Modifications to the Opinion in the Independent Auditor's Report
- AU-C 706, Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report

2

## Background

### Convergence

- Primarily with IAASB
- PCAOB has issued similar standard

### Feedback from users of Financial Statements

- Like pass fail model
- Want more info about significant aspects of audit
- Boilerplate language with little transparency

3

## Effective Date

- Effective for audits of financial statements for periods ending on or after December 15, 2020.
  - Early implementation is NOT permitted

4

## AU-C 700



5

### Scope

- Not applicable when the auditor is forming an opinion and reporting on financial statements of employee benefit plans subject to the Employee Retirement Income Security Act of 1974 (ERISA)

6

## Objectives

### The objectives of the auditor:

- Form an opinion on the financial statements based on an evaluation of the audit evidence obtained, including evidence obtained about comparative financial statements or comparative financial information.
- Express clearly the opinion on the financial statements through a written report.

7

## Opinion Section - First

### *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.

8

## Followed by Basis for Opinion

### *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.

9

## Relevant Ethical Requirements

- Ethical requirements consist of the AICPA Code of Professional Conduct together with rules of state boards of accountancy and applicable regulatory agencies that are more restrictive.
- When the AICPA Code of Professional Conduct applies, the auditor's other ethical responsibilities relate to the principles of professional conduct.

10

## Management's Responsibilities

### *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].

11

## Auditor's Responsibilities

### *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, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users made on the basis of these financial statements.

12

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.<sup>2</sup>
- 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.

13

## Auditor's Responsibilities Cont'd

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.

14

## Optional Reporting & Close

### 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]*



15

15

AU-C 701



16

## AU-C 701

- AU-C Section 701, Communicating Key Audit Matters in the Independent Auditor's Report
  - This section addresses the auditor's responsibility to communicate key audit matters in the auditor's report when **the auditor is engaged to do so**.

17

## Key Audit Matters - Defined

### Key Audit Matters

- Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.

18

## Scope

- Applies to an audit of a complete set of general purpose financial statements
- Prohibits the auditor from communicating key audit matters when the auditor expresses an adverse opinion or disclaims an opinion on the financial statements, unless such reporting is required by law or regulation.

19

## Purpose

- The purpose of communicating key audit matters is to provide greater transparency about the audit that was performed.

20

## Context

- Communicating KAM in the auditor's report is done in the context of the auditor having formed an opinion on the financial statements as a whole.

21

## NOT KAM

### Communicating KAM does *not* constitute the following:

- A substitute for disclosures that the applicable financial reporting framework requires management to make or that are otherwise necessary to achieve fair presentation
- A substitute for the auditor expressing a modified opinion when required to do so by the circumstances of a specific audit engagement in accordance with AU-C 705
- A substitute for reporting in accordance with AU-C section 570, if, after considering identified conditions or events and management's plans, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains
- A separate opinion on individual matters

22

## How to Select KAM

- The auditor should determine, from the **matters communicated with those charged with governance**, those matters that required **significant auditor attention** in performing the audit.

23

## Other Standards

- AU-C 260, *The Auditor's Communication With Those Charged With Governance*
  - Required Communications
- AU-C 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*
  - Significant Audit Attention

24

## Current Period

- Determination of KAM is limited to those matters of most significance in the audit of the financial statements of the current period
  - Even when comparative financial statements are presented

25

## Significant Audit Attention

- Areas of higher assessed risk of material misstatement, or significant risks
- Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty
- The effect on the audit of significant events or transactions that occurred during the period

26

## Challenging

- Matters that pose challenges to the auditor in obtaining sufficient appropriate audit evidence or pose challenges to the auditor in forming an opinion may be particularly relevant in the auditor's determination of KAM.

27

## Audit Attention

- Areas of complexity and significant management judgment
- Often involve difficult or complex auditor judgments
- Affects the auditor's overall audit strategy, the allocation of resources, and the extent of audit effort in relation to such matters

28

## Significant Risks

- A significant risk is as an identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration.
- Areas of significant management judgment and significant unusual transactions may often be identified as significant risks.

29

## Entity Specific

- Significant economic, accounting, regulatory, industry, or other developments that affected management's assumptions or judgments.

30

## Relative Significance

- The auditor should determine which of the matters determined identified were of most significance

31

## Considerations

- The importance of a matter to intended users' understanding of the FS
- The matter's materiality to the FS
- The nature of the underlying accounting policy
- The complexity or subjectivity involved in management's selection of an appropriate policy compared to other entities within its industry
- The nature and materiality, quantitative or qualitative, of corrected and accumulated uncorrected misstatements due to fraud or error related to the matter, if any

32

## Considerations Cont'd

- The nature and extent of audit effort needed to address the matter, including the following:
  - The extent of specialized skill or knowledge needed to apply audit procedures to address the matter or evaluate the results of those procedures, if any
  - The nature of consultations outside the engagement team regarding the matter
- The nature and severity of difficulties in applying audit procedures, evaluating the results of those procedures, and obtaining relevant and reliable evidence on which to base the auditor's opinion, particularly as the auditor's judgments become more subjective
- The severity of any control deficiencies identified relevant to the matter
- Whether the matter involved a number of separate, but related, auditing considerations

33

## Which & How Many?

- Matter of professional judgment
- The number of key audit matters to be included in the auditor's report may be affected
  - by the size and complexity of the entity
  - the nature of its business and environment
  - the facts and circumstances of the audit engagement

34

## Interaction with AU-C 705

- The auditor should not communicate a matter in the “Key Audit Matters” section of the auditor’s report when the auditor would be required to modify the opinion in accordance with section 705 of this SAS as a result of the matter.

35

## Order of Matters

- The order of presentation of individual matters within the “Key Audit Matters” section is a matter of professional judgment.
  - May be organized in order of relative importance
  - May be based on the auditor’s judgment
  - May correspond to the manner in which matters are disclosed in the financial statements

36

## KAM Intro Paragraph

### *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 in accordance with section 701, Communicating Key Audit Matters in the Independent Auditor's Report, of this SAS]*

37

## Description of KAM

- Should include a reference to the related disclosures, if any, in the FS

### Address:

- Why the matter was considered to be one of most significance in the audit and therefore determined to be a key audit matter
- How the matter was addressed in the audit

38

## Guidelines

- The adequacy of the description of a key audit matter is a matter of professional judgment.
- Meant to provide a succinct & balanced explanation
- Limit the use of highly technical auditing terms
- Be balanced in the context of the responsibilities of the respective parties

39

## Disclosure Impact

- Not a mere reiteration of what is disclosed in the financial statements.

40

## Disclosure Reference

- In addition to referring to related disclosures, the auditor may draw attention to key aspects of them.
- The extent of disclosure by management about specific aspects or factors in relation to how a particular matter is affecting the financial statements of the current period may help the auditor pinpoint particular aspects of how the matter was addressed in the audit such that intended users can understand why the matter is a key audit matter.

41

## Intention

- The description of a KAM is intended to provide insight regarding why the matter was determined to be a key audit matter.
- Explaining the factors that led the auditor to conclude that a particular matter required significant auditor attention and was of most significance in the audit is likely to be of interest to intended users.

42

## Entity Specific

- Relating a matter directly to the specific circumstances of the entity may also help minimize the potential that such descriptions become overly standardized and less useful over time.

43

## Principal Considerations

- Make reference to the principal considerations that led the auditor, in the circumstances of the audit, to determine the matter to be one of most significance.
  - Economic conditions that affected the auditor's ability to obtain audit evidence, for example, illiquid markets for certain financial instruments
  - New or emerging accounting policies, for example, entity-specific or industry-specific matters on which the engagement team consulted
  - Changes in the entity's strategy or business model that had a material effect on the financial statements

44

## How Addressed

- The amount of detail to be provided is a matter of professional judgment.

### Consider:

- Aspects of the auditor's response or approach that were most relevant to the matter or specific to the assessed risk of material misstatement
- A brief overview of procedures performed
- An indication of the outcome of the auditor's procedures
- Key observations with respect to the matter

45

## Take Care

- Do not imply that the matter has not been appropriately resolved by the auditor in forming the opinion on the FS
- Relate the matter directly to the specific circumstances of the entity, while avoiding generic or standardized language
- Take into account how the matter is addressed in the related disclosures in the financial statements, if any
- Do not contain or imply discrete opinions on separate elements of the financial statements

46

## How Addressed

- May consider it necessary to describe certain procedures that were performed to explain how a matter was addressed in the audit
  - May typically be at a high level, rather than a detailed description of all procedures performed regarding the matter

47

## Original Information

- Original information is any information about the entity that has not otherwise been made publicly available by the entity
  - Such information is the responsibility of the entity's management and those charged with governance

48

## Original Information Cont'd

- Although the auditor seeks to avoid providing original information about the entity, it may be necessary to do so in the description of a key audit matter.
  - Such information may be necessary to appropriately explain why the matter was considered to be one of most significance in the audit, and therefore determined to be a key audit matter, and how the matter was addressed in the audit, provided that disclosure of such information is not precluded by law or regulation.

## Original Information Cont'd

- Management may elect to expand or supplement the entity's disclosures, rather than having the auditor provide original information in the auditor's report.

## Do Not Report KAM

- When law or regulation precludes disclosure about the matter.
- In extremely rare circumstances, the auditor determines that the matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.
  - Does not apply if information about the matter is available outside the entity.

51

## No KAM

- In the rare circumstance that the auditor determines that there are no key audit matters.
- The auditor determines that a KAM will not be communicated in the auditor's report and no other matters have been determined to be KAM.
- The only matters determined to be KAM are going concern or qualified opinion related.

52

## Report – No KAM

### Key Audit Matters

*[Except for the matter described in the Basis for Qualified Opinion section or Going Concern section,] We have determined that there are no [other] key audit matters to communicate in our report.*

53

## Documentation

- The matters that required significant auditor attention and the rationale for the auditor's determination about whether each of the matters is a key audit matter
- The rationale for the auditor's determination that there are no key audit matters to communicate
- The rationale for the auditor's determination not to communicate in the auditor's report a matter determined to be a key audit matter

54

# AU-C 705



55

## Qualified Opinion

### *Qualified 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, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, 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.

56

### *Basis for Qualified Opinion*

ABC Company has stated inventories at cost in the accompanying balance sheets. Accounting principles generally accepted in the United States of America require inventories to be stated at the lower of cost or market. If the Company stated inventories at the lower of cost or market, a write down of \$XXX and \$XXX would have been required as of December 31, 20X1 and 20X0, respectively. Accordingly, cost of sales would have been increased by \$XXX and \$XXX, and net income, income taxes, and stockholders' equity would have been reduced by \$XXX, \$XXX, and \$XXX, and \$XXX, \$XXX, and \$XXX, as of and for the years ended December 31, 20X1 and 20X0, respectively.

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 qualified audit opinion.

57

## Adverse Opinion

### *Adverse Opinion*

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

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion section of our report, the accompanying consolidated financial statements do not present fairly the financial position of ABC Company and its subsidiaries as of December 31, 20X1, or the results of their operations or their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

58

***Basis for Adverse Opinion***

As described in Note X, ABC Company has not consolidated the financial statements of subsidiary XYZ Company that it acquired during 20X1 because it has not yet been able to ascertain the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This investment is therefore accounted for on a cost basis by the Company. Under accounting principles generally accepted in the United States of America, the subsidiary should have been consolidated because it is controlled by the Company. Had XYZ Company been consolidated, many elements in the accompanying consolidated financial statements would have been materially affected. The effects on the consolidated financial statements of the failure to consolidate have not been determined.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse audit opinion.

59

## Disclaimer of Opinion

***Disclaimer of Opinion***

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

We do not express an opinion on the accompanying financial statements of ABC Company. Because of the significance of the matter described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements.

60

## Disclaimer Cont'd

### *Basis for Disclaimer of Opinion*

ABC Company's investment in XYZ Company, a joint venture, is carried at \$XXX on the Company's balance sheet, which represents over 90 percent of the Company's net assets as of December 31, 20X1. We were not allowed access to the management and the auditors of XYZ Company. As a result, we were unable to determine whether any adjustments were necessary relating to the Company's proportional share of XYZ Company's assets that it controls jointly, its proportional share of XYZ Company's liabilities for which it is jointly responsible, its proportional share of XYZ Company's income and expenses for the year, and the elements making up the statements of changes in stockholders' equity and cash flows.

61

## Disclaimer Cont'd

### *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]*.

62

## Disclaimer Cont'd

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

Our responsibility is to conduct an audit of ABC Company's financial statements in accordance with auditing standards generally accepted in the United States of America and to issue an auditor's report. However, because of the matter described in the Basis for Disclaimer of Opinion section of our report, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit.

63

AU-C 706



64

## EOM

- If the auditor considers it necessary to draw users' attention to a matter appropriately presented or disclosed in the financial statements that, in the auditor's professional judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor should include an emphasis-of-matter paragraph in the auditor's report, provided that the following apply:
  - The auditor would not be required to modify the opinion in accordance with AU-C 705 as a result of the matter.
  - The matter has not been determined to be a key audit matter to be communicated in the auditor's report.

65

## OM

- If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's professional judgment, is relevant to users' understanding of the audit, the auditor's responsibilities, or the auditor's report, the auditor should include an other-matter paragraph in the auditor's report, provided that, the matter has not been determined to be a key audit matter to be communicated in the auditor's report.

66

## EOM vs KAM

- The use of EOM paragraphs is not a substitute for a description of individual KAM.

67

## Placement

- When a “Key Audit Matters” section is presented in the auditor’s report, an EOM paragraph may be presented either directly before or after the “Key Audit Matters” section, based on the auditor’s judgment about the relative significance of the information included in the emphasis-of-matter paragraph.

68

## Placement

- When a “Key Audit Matters” section is presented in the auditor’s report and an other-matter paragraph is also considered necessary, the auditor may add further context to the heading “Other Matter,” such as “Other Matter — Scope of the Audit,” to differentiate the other-matter paragraph from the individual matters described in the “Key Audit Matters” section.
- When an other-matter paragraph is included to draw users’ attention to a matter relating to other reporting responsibilities addressed in the auditor’s report, the paragraph may be included in the section “Report on Other Legal and Regulatory Requirements.”
- When it is relevant to all the auditor’s responsibilities or to users’ understanding of the auditor’s report, the other-matter paragraph may be included as a separate section following the sections “Report on the Audit of the Financial Statements” and “Report on Other Legal and Regulatory Requirements.”

69

### *Basis for Opinion*

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor’s Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### *Emphasis of Matter*

As discussed in Note X to the financial statements, ABC Company is a defendant in a lawsuit [*briefly describe the nature of the litigation consistent with the Company’s description in the note to the financial statements*]. Our opinion is not modified with respect to this matter.

### *Responsibilities of Management for the Financial Statements*

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

70

***Basis for Opinion***

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

***Emphasis of Matter<sup>3</sup>***

As discussed in Note X to the financial statements, subsequent to the date of the financial statements, there was a fire in ABC Company's production facilities. Our opinion is not modified with respect to this matter.

***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.

71



**GALASSO**  
LEARNING SOLUTIONS



**What Questions  
Do You Have?**

**Melisa F. Galasso**  
Chief Executive

Melisa@galassolearningsolutions.com  
<http://galassolearningsolutions.com>

72