
**STAFF GUIDANCE
CHANGES TO THE AUDITOR'S REPORT
EFFECTIVE FOR AUDITS OF FISCAL YEARS ENDING
ON OR AFTER DECEMBER 15, 2017**

UPDATED AS OF AUGUST 23, 2018

This guidance was prepared by PCAOB staff to help firms when implementing changes to the auditor's report effective for audits of fiscal years ending on or after December 15, 2017. This staff guidance document sets forth the staff's views on issues related to the implementation of the rules and standards of the PCAOB. It does not constitute rules of the Board, nor has it been approved by the Board. It supplements PCAOB Release No. 2017-001, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards* (June 1, 2017).

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Summary of August 23, 2018 Updates

Below is a summary of the updates made to this guidance from the previous version issued on December 28, 2017. Clicking a linked update description will direct you to the updated section.

| Section | Update |
|--|--|
| Annotated Example Auditor's Report | Adds voluntary disclosure about certain audit participants in the audit |
| Auditor Tenure | Adds footnote on determining tenure for employee benefit plans Adds examples of company filings that could be used to determine tenure Adds guidance regarding uncertainty about the specific year for tenure Adds guidance on tenure reporting by predecessor auditors |
| Auditor Reporting Regarding Internal Control Over Financial Reporting ("ICFR") | Adds guidance regarding reporting when ICFR audits are required by other regulators Adds guidance on reporting auditor tenure in a separate auditor's report on ICFR |
| Explanatory and Emphasis Paragraphs | Provides guidance on location of explanatory paragraphs in the auditor's report Adds examples of matters that might be emphasized |
| Voluntary Disclosure about Certain Audit Participants | Adds information about the voluntary disclosure of the engagement partner and other accounting firms participating in the audit |
| Other Reporting Situations | Adds guidance on auditor reporting on supplemental information, interim financial information, and special reports |

Introduction

On June 1, 2017, the PCAOB adopted a new auditing standard, AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*,¹ to enhance the relevance and usefulness of the auditor's report by providing additional and important information to investors and other financial statement users. This standard and related amendments were approved by the SEC on October 23, 2017.

The standard retains the pass/fail opinion of the existing auditor's report but makes significant changes to the report. All of the changes, except those relating to critical audit matters ("CAMs"), are effective for audits of fiscal years ending on or after December 15, 2017. These changes are primarily intended to clarify the auditor's role and responsibilities related to the audit of the financial statements, provide additional information about the auditor, and make the auditor's report easier to read. This guidance addresses these key elements of the revised auditor's report.

The other significant change, auditor communication of CAMs, is permissible on a voluntary basis but will not be required until audits of fiscal years ending on or after June 30, 2019 (for audits of "large accelerated filers") or December 15, 2020 (for audits of all other companies to which the requirements apply).²

The PCAOB will monitor the implementation of the new requirements and issue additional guidance, as needed.

The annotated example of the new auditor's report highlights the key changes (new language is underlined), followed by explanations.

¹ See *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards*, PCAOB Release No. 2017-001 (June 1, 2017). Auditors should refer to AS 3105, *Departures from Unqualified Opinions and Other Reporting Circumstances*, for reporting requirements related to departures from unqualified opinions and other reporting circumstances. AS 3105 generally requires the same basic elements and, if applicable, CAMs as would be required under AS 3101.

² For more information about CAM requirements, see PCAOB Release No. 2017-001 and AS 3101.11-17.

Annotated Example Auditor's Report

Report of Independent Registered Public Accounting Firm

To the shareholders and the board of directors of X Company

Addressee

Opinion on the Financial Statements

Opinion Section

We have audited the accompanying balance sheets of X Company (the "Company") as of December 31, 20X2 and 20X1, the related statements of [titles of the financial statements, e.g., income, comprehensive income, stockholders' equity, and cash flows], for each of the three years in the period ended December 31, 20X2, and the related notes [and schedules] (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of [at] December 31, 20X2 and 20X1, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 20X2, in conformity with [the applicable financial reporting framework].

Auditor Independence

Basis for Opinion

Basis for Opinion Section

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. [The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.]

ICFR Explanatory Language, if applicable

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matters [if applicable]

CAMs, when effective

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

[Include critical audit matters]

[Engagement Partner Disclosure]

The engagement partner on our audit for the year ended December 31, 20X2, was [full name of engagement partner].

Other Accounting Firms

In this audit, the other accounting firms listed below performed audits or audit procedures. We are responsible for the audits or audit procedures performed by these other accounting firms and, accordingly, supervised or performed procedures to assume responsibility for their work in accordance with PCAOB standards. The portion of the total audit hours attributable to audits and audit procedures performed by these firms in our audit was:

(List firms with location by range or specific percentage of participation)]

[Signature]

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

Auditor Tenure

[City and State or Country]

[Date]

Disclosure About Certain Audit Participants (voluntary)

A. Key Changes Effective December 15, 2017

1. Form of the Auditor's Report

AS 3101.08-.09 require that the Opinion on the Financial Statements section be the first section, immediately followed by the Basis for Opinion section. This approach allows for consistency in the location of the Opinion on the Financial Statements and Basis for Opinion sections, with flexibility for other elements of the auditor's report, such as auditor tenure and emphasis paragraphs.

In general, the order of the remaining sections of the auditor's report is not specified. However, PCAOB standards relating to required explanatory paragraphs may specify the location of such paragraphs within the auditor's report. See Section A.6.a below.

Section titles have been added to the auditor's report to guide the reader. AS 3101.08-.09 require titles for the Opinion on the Financial Statements and Basis for Opinion sections, respectively. Other requirements for titles appear where the content of the relevant section is specified.³

2. Addressee

AS 3101.07 requires the auditor's report to be addressed to the shareholders and the board of directors, or equivalents for companies not organized as corporations. For example, for companies not organized as corporations, the auditor's report would generally be addressed to (1) the plan administrator and plan participants for benefit plans; (2) the directors (or equivalent) and equity owners for brokers or dealers; and (3) the trustees and unit holders or other investors for investment companies organized as trusts. The auditor's report may include additional addressees. Since inclusion of additional addressees is voluntary, auditors can assess, based on the individual circumstances, whether or not to include additional addressees in the auditor's report.

3. Auditor Independence

AS 3101.09.g requires a statement in the Basis for Opinion section that the auditor is a public accounting firm registered with the PCAOB (United States) and is required to be independent with respect to the company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the SEC and the PCAOB.

4. Auditor Tenure

AS 3101.10.b requires a statement in the auditor's report containing the year the auditor began serving consecutively as the company's auditor. The disclosure of tenure should reflect the entire relationship between the company and the auditor, including the tenure of predecessor accounting firms and engagement by predecessors of the company under audit.⁴

³ For example, the requirement to include a title with a going concern explanatory paragraph appears in AS 2415, *Consideration of an Entity's Ability to Continue as a Going Concern*.

⁴ A company's benefit plan that files annual reports on Form 11-K would be considered a separate issuer. Therefore, it would have a separate tenure determination.

a. Determination of Tenure

In determining the year the auditor began serving consecutively as the company's auditor, the auditor would look to the year when the firm signs an initial engagement letter to audit a company's financial statements or when the firm begins performing audit procedures, whichever is earlier. The following examples illustrate this:

If the auditor signs the engagement letter in January 2012 to audit a company's financial statements for the year ended December 31, 2012, and the auditor's report is dated February 28, 2013, the auditor would state 2012 as the year the auditor began serving consecutively as the company's auditor.

If the auditor signs the engagement letter in December 2011 to audit a company's financial statements for the years ended December 31, 2010, 2011, and 2012, the auditor would state 2011 as the year the auditor began serving consecutively as the company's auditor.

If the auditor signs the engagement letter in January 2013 to audit a company's financial statements for the years ended December 31, 2010, 2011, and 2012, the auditor would state 2013 as the year the auditor began serving consecutively as the company's auditor.

If auditors cannot readily determine when an initial engagement letter was signed, they can determine tenure based on their own records, the company's records, or publicly available information, such as annual reports on Form 10-K, current reports on Form 8-K reporting a change in the company's independent registered public accounting firm, or other company filings available on the SEC's Electronic Data Gathering, Analysis, and Retrieval ("EDGAR") system.

In the absence of other evidence about when the auditor signed an initial engagement letter or began performing audit procedures, tenure can be determined based on the year in which the auditor first issued an audit report on the company's financial statements or, if earlier, the auditor's estimate of when work would have commenced to enable the issuance of such report.

Auditor tenure is calculated taking into account firm or company mergers, acquisitions, or changes in ownership structure. When a company acquires another company, if the acquirer's⁵ current auditor continues serving as the combined company's auditor, auditor tenure would continue. If the acquired company's auditor is selected to serve as the combined company's auditor, auditor tenure would begin at that time.

The auditor's relationship with the company is not affected by the company's status as a public company. If a company went public and maintained the same auditor, auditor tenure will include the years the auditor served as the company's auditor both before and after the company became subject to SEC reporting requirements.

b. Reporting of Tenure

AS 3101 does not specify a required location within the auditor's report for the statement on auditor tenure. The example auditor's report (on page 3) includes the statement on auditor tenure

⁵ For purposes of calculating auditor tenure, acquirer means the accounting acquirer.

at the end of the report; however, auditors have discretion to present auditor tenure in the part of the auditor's report they consider appropriate.

Auditors have discretion to provide additional information in the auditor's report about tenure, if the information would provide context or otherwise assist the reader's understanding of the relationship between the auditor and the company. For example, when tenure is calculated taking into account the tenure of predecessor accounting firms and/or engagement by predecessors of the company under audit, the auditor may provide information about these historical relationships.

Uncertainty About the Specific Year for Tenure

If there is uncertainty as to the specific year the auditor began serving consecutively as the company's auditor, such as due to firm or company mergers, acquisitions, or changes in ownership structure, the Note to AS 3101.10.b says the auditor should state that the auditor is uncertain as to the year the auditor became the company's auditor and provide the earliest year of which the auditor has knowledge. The following is an example of such a statement that could be included in the auditor's report:

We are uncertain as to the year we [or our predecessor firms] began serving consecutively as the auditor of the Company's financial statements; however, we are aware that we [or our predecessor firms] have been Company X's auditor [or Company X's auditor subsequent to the Company's merger] consecutively since at least 19XX.

Auditors may use other language to express uncertainty regarding when tenure began, as long as the statement effectively communicates the first year the firm knows that it served as the company's auditor and that it is uncertain of the specific year when tenure began, such as:

We have not been able to determine the specific year that we began serving as Company Y's auditor; however, we are aware that we have served as Company Y's auditor since at least 19XX.

We have served as Company Z's auditor since at least 19XX; however, an earlier year could not be reliably determined.

The explanatory language should not state or imply that the auditor did not make a tenure determination (e.g., "we have not determined the specific year in which we first served as Company X's auditor").

c. Determination and Reporting of Tenure for Investment Companies

For an investment company that is part of a group of investment companies, AS 3101.10.b provides that the auditor's statement regarding tenure will contain the year the auditor began serving consecutively as the auditor of any investment company in the group of investment companies. The following example illustrates this:

| |
|---|
| <p>If Firm A has been auditing investment companies in XYZ group of investment companies since 1980, the current auditor's report for XYZ fixed income fund, whose inception date was in 2010, will state that Firm A has served as the auditor of one or more XYZ investment companies since 1980.</p> |
|---|

d. Tenure Reporting by Predecessor Auditors

When an auditor's report is reissued by a predecessor auditor, the predecessor auditor may expand the tenure statement to indicate when its tenure ended.

5. Auditor Reporting Regarding Internal Control Over Financial Reporting ("ICFR")

a. Management Reports on ICFR with no Auditor Reporting

In some circumstances, management is required to report on the company's ICFR but such report is not required to be audited,⁶ and the auditor is not engaged to perform an audit of management's assessment of the effectiveness of ICFR. In such cases, under AS 3105.59, the auditor is required to include explanatory language to that effect in the Basis for Opinion section. The example auditor's report (on page 3) illustrates this presentation.⁷ If an audit of ICFR of the issuer is performed, whether pursuant to SEC rules, the rules of another regulator, or otherwise, AS 3105.59 and the explanatory language in AS 3105.60 are not applicable.⁸

b. Management Reports on ICFR with Auditor Reporting

The requirements for auditor reporting on management reports on ICFR have been updated to conform to AS 3101.⁹ AS 2201.87 presents an updated example of a combined report expressing an unqualified opinion on financial statements and an unqualified opinion on ICFR.

Alternatively, if the auditor issues separate reports on ICFR and the financial statements, under AS 2201.88 the required paragraph referencing the separate report should appear in the Opinion on the Financial Statements section, immediately following the opinion paragraph. The disclosure of auditor tenure is not required in the auditor's separate report on ICFR.

6. Explanatory and Emphasis Paragraphs

a. Explanatory Paragraphs

The auditor is required to add explanatory language to the auditor's report under circumstances listed in AS 3101.18. The key change to the list of circumstances is the new explanatory language for when an audit of ICFR is not performed as described in Section 5 above.

⁶ This may be the case for companies that are subject to Section 404(a) of the Sarbanes-Oxley Act of 2002, as amended, which mandates management ICFR reporting, but not Section 404(b), which mandates auditor ICFR reporting. Section 404(a) generally applies to companies that are subject to the reporting requirements of the Securities Exchange Act of 1934, other than registered investment companies. Certain categories of companies that are subject to Section 404(a), such as nonaccelerated filers and emerging growth companies, are not subject to Section 404(b). See Item 308 of Regulation S-K.

⁷ A similar paragraph may be voluntarily included in the auditor's report in situations in which management is not required to report on ICFR and neither is the auditor.

⁸ An ICFR audit of a subsidiary of the issuer (for example, pursuant to banking regulations) would not affect the determination of whether AS 3105.59-60 are applicable.

⁹ See paragraphs .85-.88 of AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

The list of circumstances in AS 3101.18 includes references to other PCAOB standards in which these circumstances and related reporting requirements are described. Some of these standards require the use of an appropriate section title.

Specific Location Required

Some PCAOB standards specify the location of required explanatory language within the auditor's report. For example, if a paragraph describing an uncertainty about the entity's ability to continue as a going concern is included pursuant to AS 2415, the auditor would include the paragraph, with an appropriate title, immediately following the opinion paragraph. Similarly, explanatory paragraphs for a material change in accounting principle and the correction of a material misstatement in previously issued financial statements under AS 2820, *Evaluating Consistency of Financial Statements*, would appear in the same location.

The following illustrates the location of such an explanatory paragraph in the auditor's report:

Opinion on the Financial Statements

[Same basic elements as the *Opinion on the Financial Statements* section of the auditor's report in AS 3101]

[Appropriate section title, such as *Going Concern* or *Correction of a Material Misstatement*]

[Required explanatory paragraph]

Basis for Opinion

[Same basic elements as the *Basis for Opinion* section of the auditor's report in AS 3101]

No Specific Location Required

If the auditor is required to include explanatory language in the auditor's report but the location is not specified, the language may be placed where the auditor considers appropriate.

b. *Emphasis Paragraphs*

The auditor may add a paragraph to the auditor's report to emphasize a matter regarding the financial statements ("emphasis paragraph"). Emphasis paragraphs are not required, but may be used by auditors to draw the reader's attention to matters such as significant transactions with related parties and unusually important subsequent events. The following are examples of matters, among others, that might be emphasized in the auditor's report:¹⁰

- a. Significant transactions, including significant transactions with related parties;
- b. Unusually important subsequent events, such as a catastrophe that has had, or continues to have, a significant effect on the company's financial position;

¹⁰ See AS 3101.19.

- c. Accounting matters, other than those involving a change or changes in accounting principles, affecting the comparability of the financial statements with those of the preceding period;
- d. An uncertainty relating to the future outcome of significant litigation or regulatory actions; and
- e. That the entity is a component of a larger business enterprise.

When an emphasis paragraph is included in the auditor's report, it is not appropriate for the auditor to use phrases such as "with the foregoing [following] explanation" in the opinion paragraph.

Since AS 3101.19 does not specify the location for an emphasis paragraph within the auditor's report, the paragraph may be placed where the auditor considers appropriate. If the auditor includes an emphasis paragraph in the auditor's report, the auditor is required to use an appropriate section title.

7. Voluntary Disclosure about Certain Audit Participants

AS 3101.20 permits the auditor to include in the auditor's report information regarding the engagement partner and/or other accounting firms participating in the audit that is required to be reported on PCAOB Form AP, *Auditor Reporting of Certain Audit Participants*.¹¹ The auditor may include information about the engagement partner, information about the other accounting firms, or both. If the auditor includes information about the other accounting firms in the auditor's report, all other accounting firms required to be disclosed on Form AP must be included in the auditor's report.

If the auditor decides to provide information about the engagement partner, other accounting firms participating in the audit, or both, AS 3101.20 requires the auditor to disclose the following:

- a. *Engagement partner*—the engagement partner's full name as required on Form AP; or
- b. *Other accounting firms participating in the audit*—
 - i. A statement that the auditor is responsible for the audits or audit procedures performed by the other public accounting firms and has supervised or performed procedures to assume responsibility for their work in accordance with PCAOB standards;
 - ii. *Other accounting firms individually contributing 5% or more of total audit hours*—for each firm, (1) the firm's legal name, (2) the city and state (or, if outside the United States, city and country) of the headquarters' office, and (3) percentage of total audit hours as a single number or within an appropriate range, as is required to be reported on Form AP; and

¹¹ For additional information on voluntary disclosure in the auditor's report, see *Improving the Transparency of Audits: Rules to Require Disclosure of Certain Audit Participants on a New PCAOB Form and Related Amendments to Auditing Standards*, PCAOB Release No. 2015-008 (Dec. 15, 2015), and related staff guidance.

- iii. *Other accounting firms individually contributing less than 5% of total audit hours*—(1) the number of other accounting firms individually representing less than 5% of total audit hours and (2) the aggregate percentage of total audit hours of such firms as a single number or within an appropriate range, as is required to be reported on Form AP.

If the auditor decides to provide information about certain audit participants in the auditor's report, the auditor should use an appropriate section title.

8. Other Reporting Situations

The Appendix provides guidance regarding the following other reporting situations:

- Supplemental Information
- Review of Interim Financial Information
- Special Reports

B. Critical Audit Matters

Provisions related to CAMs will take effect for audits of financial statements for fiscal years ending on or after June 30, 2019, for large accelerated filers; and for audits of financial statements for fiscal years ending on or after December 15, 2020, for all audits of other companies to which the requirements apply.

When the relevant requirements take effect, auditors of certain issuers will be required to include in the auditor's report a communication regarding CAMs. CAMs are defined under AS 3101 as matters arising from the audit of the financial statements that have been communicated or were required to be communicated to the audit committee and that (1) relate to accounts or disclosures that are material to the financial statements and (2) involved especially challenging, subjective, or complex auditor judgment.¹²

The communication of CAMs is not required for audits of emerging growth companies; brokers and dealers; investment companies other than business development companies; and employee stock purchase, savings, and similar plans.

CAMs may be included voluntarily before the effective date or for entities for which the requirements do not apply. In advance of implementation, auditors may want to discuss the new CAM requirements with management and audit committees.

¹² For more information about the CAM requirements, see AS 3101.11-17. and additional discussion in the relevant PCAOB releases.

Contact Information

Questions pertaining to AS 3101 and related amendments may be directed to the staff in the PCAOB's Office of the Chief Auditor via the standards' help line at (202) 591-4395 or may be submitted through a web form.¹³

¹³ The web form is available at <https://pcaobus.org/About/Pages/ContactUsWebForm.aspx?Contact=Standard-related%20Inquiries>.

Appendix - Other Reporting Situations

A. Supplemental Information

Paragraph .11 of AS 2701, *Auditing Supplemental Information Accompanying Audited Financial Statements*, allows the auditor's report on supplemental information to be included in the auditor's report on the financial statements, but does not specify a location. Since there is no specified location, such report may be placed where the auditor considers appropriate. Additionally, although not required, an appropriate section title may be added to aid the reader in distinguishing the auditor's report on supplemental information from the other sections of the auditor's report on the financial statements.

The following is an example of one possible approach:

Opinion on the Financial Statements

[Same basic elements as the Opinion on the Financial Statements section of the auditor's report in AS 3101]

Basis for Opinion

[Same basic elements as the Basis for Opinion section of the auditor's report in AS 3101]

[Appropriate section title, such as Auditor's Report on Supplemental Information]

[Include language from AS 2701.13]

B. Review of Interim Financial Information

The reporting requirements in AS 4105, *Reviews of Interim Financial Information*, conform to the requirements of AS 3101. AS 4105.37C.e requires the auditor to include a statement on auditor independence in the auditor's report on the review of interim financial information. This statement is required to be included in the Basis for Review Results section of the report.

The following is an example of one possible approach of including this statement in the review report:

Basis for Review Results

This [These] interim financial information [statements] is [are] the responsibility of the Company's management. We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"). We are a public accounting firm registered with the 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.

A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the PCAOB, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

C. Special Reports

AS 3305, *Special Reports*, provides reporting requirements for various types of special reports, such as reports on specified elements, accounts, or items of a financial statement. AS 3305.01 includes a note indicating that if a special report is filed with the SEC, the auditor's report is required to include the basic elements that would be required in an unqualified auditor's report under AS 3101.

Additionally, for reports on financial statements that are prepared in conformity with a comprehensive basis of accounting other than generally accepted accounting principles under AS 3305.01.a, the auditor is required to communicate CAMs, when applicable.