
Standard on Auditing (SA) 705

Modifications to the Opinion in the Independent Auditors Report

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Scope of SA

- ▶ Auditor's responsibility to,
- ▶ Issue an appropriate report in circumstances when,
- ▶ In forming an opinion as per Revised SA 700,
- ▶ Auditor concludes a modification to auditor's opinion is necessary.

Types of modified opinion

Qualified opinion

- ▶ Adverse opinion
- ▶ Disclaimer of opinion

- ▶ Depends on the
 - ▶ Nature of the matter
 - ▶ Likelihood of material misstatement
 - ▶ Inability to obtain sufficient appropriate audit evidence
 - ▶ Auditor judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements .

Objective

- ▶ Express clearly an appropriately modified opinion on FS that is necessary when auditor:
 - ▶ CONCLUDES (based on audit evidence obtained) that FS are as a whole not free from material misstatements.
- OR**
- ▶ UNABLE to obtain SAAE to conclude that FS as a whole are free of material misstatements.

Definitions

Pervasive -

A term used, in the context of misstatements, to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate audit evidence.

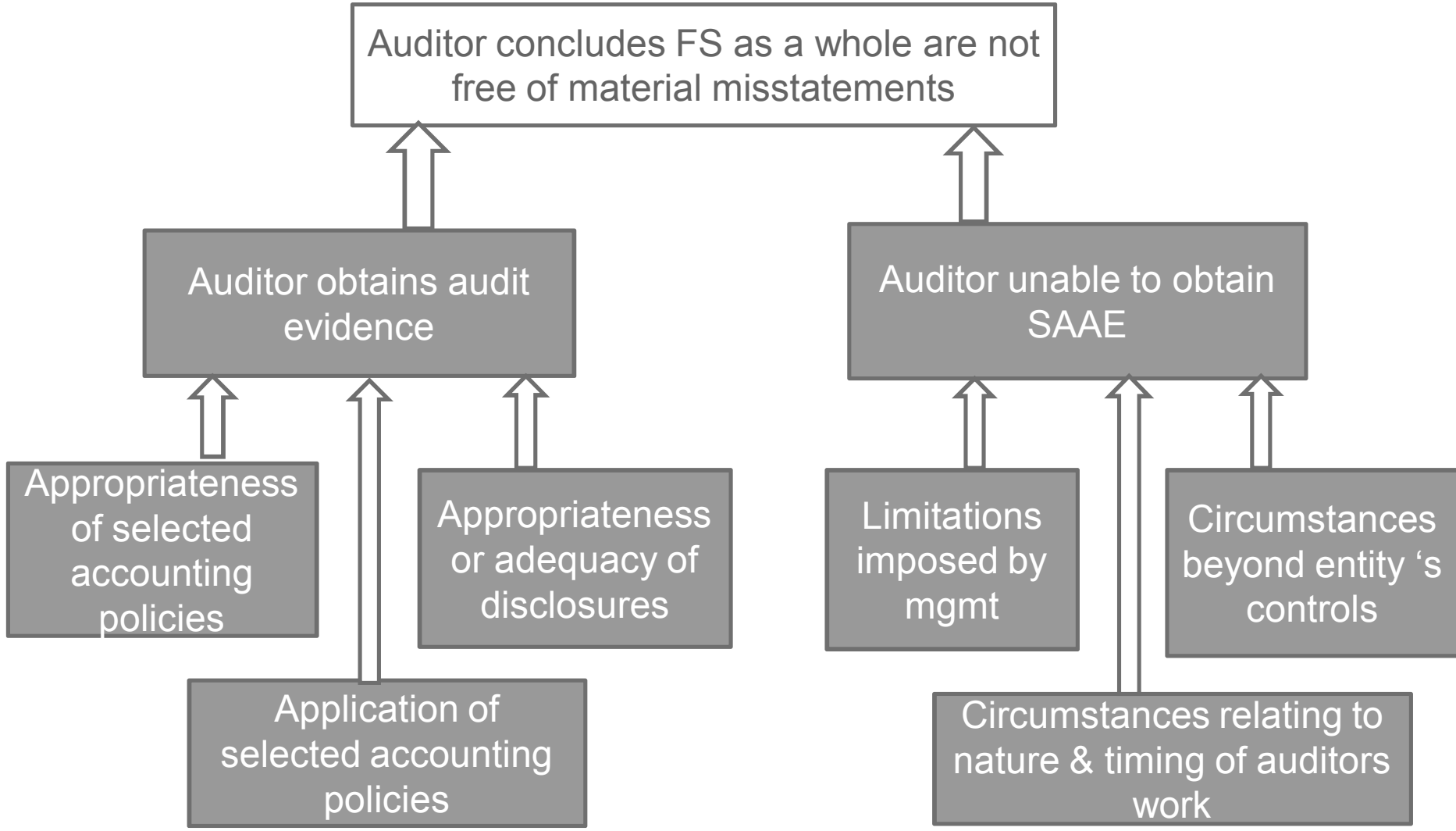
Pervasive effects on the financial statements are those that, in the auditor's judgment:

- (i) Are not confined to specific elements, accounts or items of the financial statements;
- (ii) If so confined, represent or could represent a substantial proportion of the financial statements; or
- (iii) In relation to disclosures, are fundamental to users' understanding of the financial statements.

Definitions

- ▶ Modified opinion –
 - ▶ A qualified opinion,
 - ▶ an adverse opinion or
 - ▶ a disclaimer of opinion

Requirements – Circumstances when a modification to auditors opinion is required



Types of opinion- segregation

Nature of the matter giving rise to modification	Auditors decision about the pervasive effects or possible pervasive effects on the financial statement	Auditors decision about the pervasive effects or possible pervasive effects on the financial statement
	Material but not pervasive	Material and pervasive
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate evidence	Qualified opinion	Disclaimer of opinion

Nature of material misstatement

- ▶ A material misstatement of the financial statements may arise in relation to:
 - (a) The appropriateness of the selected accounting policies;
 - (b) The application of the selected accounting policies; or
 - (c) The appropriateness or adequacy of disclosures in the financial statements.

Nature of material misstatement – Appropriateness of the selected accounting policies

- (a) The selected accounting policies are not consistent with the applicable financial reporting framework; or
(*not as per applicable framework*)

- (b) The financial statements, including the related notes, do not represent the underlying transactions and events in a manner that achieves fair presentation.
(*presentation is not appropriate*)

Nature of material misstatement- Application of selected accounting policies

- ▶ Material misstatement may arise in the following situations
 - (a) When management has not applied the selected accounting policies consistently with the financial reporting framework, including when management has not applied the selected accounting policies consistently between periods or to similar transactions and events (**consistency in application**); or
 - (b) Due to the method of application of the selected accounting policies (***such as an unintentional error in application***)

Nature of material misstatement – Appropriateness or Adequacy of Disclosures in the Financial Statements

- ▶ Material misstatements of the financial statements may arise when:
 - (a) The financial statements do not include all of the disclosures required by the applicable financial reporting framework;
 - (b) The disclosures in the financial statements are not presented in accordance with the applicable financial reporting framework; or
 - (c) The financial statements do not provide the disclosures necessary to achieve fair presentation.

Nature of an Inability to Obtain Sufficient Appropriate Audit Evidence

Inability to obtain sufficient appropriate evidence may arise due to the following three reasons :

- (a) Circumstances beyond the control of the entity;
(records destroyed due to act of nature , records seized by the government)

- (b) Circumstances relating to the nature or timing of the auditor's work; or
(appointed after the year end , controls ineffective , etc)

- (c) Limitations imposed by management.
(prevention of inventory physical verification , external confirmation not circulated etc, scope restriction)

Nature of an Inability to Obtain Sufficient Appropriate Audit Evidence

- ▶ Auditor requests the management to remove the limitation
- ▶ If the limitation is not removed then he shall communicate the same with those charged with governance .
- ▶ If the possible misstatement is material but not pervasive as concluded by the auditor then he shall qualify the opinion .
- ▶ If the possible misstatement is material and pervasive as concluded by the auditor then he shall resign if not prohibited by law else give a disclaimer of opinion .

Other Considerations Relating to an Adverse Opinion or Disclaimer of Opinion

- ▶ Where the auditor has issued a qualified , adverse or a disclaimer of an opinion for the financial statement as a whole , then he cannot give an unmodified opinion for any element or component of the financial statement in respect of the same due to inherent contradictions and not to contradict the opinion on the whole financials .

Modified Opinion - Form & Content of Auditor's Report

- ▶ **Basis of Modification Para:**

- ▶ In addition to other elements as per SA 700(R).
- ▶ Amend Auditor's responsibility statement.
- ▶ Description of matter giving rise to modification.
- ▶ Placed immediately before Opinion Para.
- ▶ Use heading "*Basis for Opinion*".

- ▶ **Opinion Para:**

- ▶ Use heading "Qualified Opinion", "Adverse Opinion", or "Disclaimer of Opinion", as appropriate.

Form and Content of the Auditor's Report When the Opinion Is Modified

Material misstatement in FS relating to:	Description in audit report
Specific amounts in FS (including quantitative disclosures)	Description & quantification of financial effects of misstatements unless impracticable. If impracticable, state so.
Narrative disclosures	Explanation of how disclosures are misstated.
Non-disclosure of info required to be disclosed	Discuss with TCWG about the omitted information. Include omitted disclosures if not prohibited by any law and it practicable to do so and SAAE has been obtained for the omitted info.
Modification results from inability to obtain SAAE	Reasons for inability.
Adverse/ disclaimer opinion	Reasons for any other matters which auditor is aware that would have required modified opinion & its effects.

Opinion paragraph - Material Misstatement

- ▶ When the auditor expresses a qualified opinion due to a material misstatement in the financial statements, the auditor shall state in the opinion paragraph that, in the auditor's opinion, except for the effects of the matter(s) described in the Basis for Qualified Opinion paragraph:
 - (a) The financial statements present fairly, in all material respects (or give a true and fair view) in accordance with the applicable financial reporting framework when reporting in accordance with a fair presentation framework;
 - or
 - (b) The financial statements have been prepared, in all material respects, in accordance with the applicable financial reporting framework when reporting in accordance with a compliance framework.

Opinion paragraph -- Unable to obtain sufficient appropriate evidence .

- ▶ When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor shall use the corresponding phrase “except for the possible effects of the matter(s)...” for the modified opinion.

Opinion paragraph - Adverse opinion

- ▶ When the auditor expresses an adverse opinion, the auditor shall state in the opinion paragraph that, in the auditor's opinion, because of the significance of the matter(s) described in the Basis for Adverse Opinion paragraph:
 - (a) The financial statements do not present fairly (or give a true and fair view) in accordance with the applicable financial reporting framework when reporting in accordance with a fair presentation framework; or
 - (b) The financial statements have not been prepared, in all material respects, in accordance with the applicable financial reporting framework when reporting in accordance with a compliance framework.

Opinion paragraph - Disclaimer of opinion – due to ability to obtain sufficient appropriate audit evidence

- ▶ When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor shall state in the opinion paragraph that:
 - (a) because of the significance of the matter(s) described in the Basis for Disclaimer of Opinion paragraph, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion; **and, accordingly,**
 - (b) the auditor does not express an opinion on the financial statements.

Description of Auditor's Responsibility When the Auditor Expresses a Qualified or Adverse Opinion

- ▶ When the auditor expresses a qualified or adverse opinion, the auditor shall amend the description of the auditor's responsibility to state that the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's modified audit opinion.

Auditor's Responsibility

When the Auditor Disclaims an Opinion– in a situation when the auditor has not been able to obtain sufficient appropriate evidence

- ▶ The auditor shall also amend the description of the auditor's responsibility and the description of the scope of the audit to state only the following: **“Our responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with Standards on Auditing issued by the Institute of Chartered Accountants of India. Because of the matter(s) described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion”.**

Communication with those charged with governance

- ▶ When the auditor expects to modify the opinion in the auditor's report, the auditor shall communicate with those charged with governance the circumstances that led to the expected modification and the proposed wording of the modification.