

SA 705- MODIFICATION TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT



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INTRODUCTION AND SCOPE

audit opinion

Introduction and Scope

Scope

- This SA applies when the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary.
- It also deals with how the form and content of the auditor's report is affected when the auditor expresses a modified opinion.

Types of Modified Opinions

- A Qualified Opinion,
- An Adverse Opinion,
- A Disclaimer of Opinion

Circumstances When a Modification to the Auditor's Opinion is Required

The objective of the auditor is to express clearly an appropriately modified opinion on the financial statements that is necessary when:

- The auditor concludes, based on the audit evidence obtained, that the financial statements as a whole are not free from material misstatement; or
- The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

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DETERMINING THE TYPE OF MODIFICATION TO THE AUDITOR'S OPINION

Determining the Type of Modification to the Auditor's Opinion

Qualified Opinion

The auditor shall express a qualified opinion when:

- The auditor obtained sufficient appropriate audit evidence which concludes that misstatements individually or in the aggregate are material, but not pervasive to the financial statements; or
- The auditor is unable to obtain sufficient appropriate audit evidence, still the auditor concludes that the effects of undetected misstatements on the financial statements could be material but not pervasive.

Example of Qualified Opinion

Independent Auditor's Report

To the shareholders of

ABC Limited

Basis for Qualified Opinion

As discussed in Note X to the financial statements, no provision for impairment has been provided on receivables of the debtor XYZ Co. which has ceased trading. The company has no security for this receivable and no cash has been received on this debt. This is not in accordance with International Financial Reporting Standards. On the basis of no security on the debt, the provision of XXX should be made for the year ended 31 December 2019. Accordingly, the profit before tax and the current assets should be reduced by XXX as at 31 December 2019.

Qualified Opinion

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion, the financial statements give a true and fair view, in all material respects, the financial position of ABC Limited as at 31 December 2019, and its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards relating to the preparation and presentation of financial statements.

Determining the Type of Modification to the Auditor's Opinion

Adverse Opinion

The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

Disclaimer of Opinion

The auditor shall disclaim an opinion that no opinion is being given regarding the financial statements of a client, when auditor is unable to obtain sufficient appropriate audit evidence due to some of following reasons:

Determining the Type of Modification to the Auditor's Opinion

- the auditor may not have been allowed or been able to complete all planned audit procedures.
- Client restricted the scope of the examination to such an extent that the auditor was unable to form an opinion.

If auditor is not able to obtain sufficient appropriate audit evidence, the auditor shall include in the Basis for Opinion section the reasons for that inability.

Example of Adverse Opinion

Basis for Adverse Opinion:

As explained in Note X, the company has not consolidated the financial statements of subsidiary XYZ Company 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. Under International Financial Reporting Standards, the subsidiary should have been consolidated because it is controlled by the company. Had XYZ been consolidated, many elements in the accompanying financial statements would have been materially affected. The effects on the consolidated financial statements of the failure to consolidate have not been determined.

Adverse Opinion:

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion paragraph, the consolidated financial statements do not present fairly (or do not give a true and fair view of) the financial position of ABC Company and its subsidiaries as at December 31, 20X1, and (of) their financial performance and their cash flows for the year then ended in accordance with International Financial Reporting Standards.

Source: <http://www.ifac.org>

Example of Disclaimer of Opinion

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with auditing standards generally accepted in the United States of America. **Because of the matter 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.**

Basis for Disclaimer of Opinion

We were unable to obtain audited financial statements supporting the Company's investment in a foreign affiliate stated at \$20,500,000, or its equity in earnings of that affiliate of \$6,250,450, which is included in net income, as described in Note 8 to the financial statements; nor were we able to satisfy ourselves as to the carrying value of the investment in the foreign affiliate or the equity in earnings by other auditing procedures.

Disclaimer of Opinion

Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on these financial statements.

Determining the Type of Modification to the Auditor's Opinion

	Auditor's Judgement Regarding the Pervasiveness of the Matter	
Nature of Matter	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



3: Material Misstatements

Material Misstatements-

A misstatement is difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. This may arise in relation to:-

- The appropriateness of the selected accounting policies
- The application of the selected accounting policies;
- The appropriateness or adequacy of disclosures in the financial statements.

Material Misstatements-

Appropriateness of the Selected Accounting Policies

Material misstatements relating to appropriateness may arise when:

- Selected accounting policies are not consistent with the applicable financial reporting framework.
- Financial statements , including notes thereon, do not represent underlying transactions and events that achieves fair presentation.

Material Misstatements



Application of the Selected Accounting Policies

Material misstatements relating to application may arise when:

- When the accounting policies are not applied consistently, including consistency between periods, similar transactions and events.
- Method of application is erroneous.

Material Misstatements-

Appropriateness or Adequacy of Disclosures in the Financial Statements

- Financial statements do not include all of the disclosures required by the applicable financial reporting framework;
- Disclosures are not presented in accordance with the applicable financial reporting framework
- Financial statements do not provide the disclosures necessary to achieve fair presentation.

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Inability to Obtain Sufficient Appropriate Audit Evidence

Inability to Obtain Sufficient Appropriate Audit Evidence

- A) Auditors' inability to obtain sufficient appropriate audit evidence may arise from:
- Circumstances beyond the control of the entity, e.g. where the records have been destroyed by fire, or seizure by government authority, etc.
 - Circumstances relating to nature or timing of the auditors' work e.g. when the auditor is appointed on such date that he cannot observe the physical count of Inventories.
 - Limitation imposed by the management

Inability to Obtain Sufficient Appropriate Audit Evidence

B) In case limitation is imposed by the management , the auditor shall request the management to remove the limitation.

C) If the management still persists, he shall communicate it to those charged with governance and determine if alternative audit procedures are possible.

D) If auditor is unable to obtain sufficient appropriate audit evidence, he shall:

- Resign from the engagement , where practicable and not prohibited by law
- If resignation is not possible due to stage of the audit or legal or professional restriction , the auditor shall give a disclaimer of opinion.

Inability to Obtain Sufficient Appropriate Audit Evidence

E) Where the auditor decides to resign, he shall inform to those charged with the governance any matters regarding misstatements identified during the audit that would have give rise to modification in the report.

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Form and Content of Modified Report

Form and Content of Modified Report

The following need to be added for modified reports:

- Basis of modification paragraph
- Amendments in the opinion paragraph
- Amendments in the auditor's responsibility paragraph

Form and Content of Modified Report

Basis of modification paragraph

This is placed immediately before the opinion paragraph and under the heading “Basis of Qualified Opinion, Basis of Adverse Opinion, Basis of Disclaimer of Opinion”

Modification may relate to:

- Specific amounts in the financial statements- in this case, include the description and quantification of the financial effects, if practicable. If not practicable, state the fact in the report
- Narrative disclosures in the financial statements- in this case explain how the disclosures are misstated

Form and Content of Modified Report

- Non- disclosure of information required to be disclosed- in this case
 - Discuss the non disclosure with those of charged with governance
 - Describe the nature of omitted information
 - If practicable, not prohibited by law and if sufficient appropriate audit evidence relating to that item is obtained, include the omitted disclosure.
- If modification results from inability to obtain sufficient appropriate audit evidence, include the reason for inability.
- Even if the auditors has expressed an adverse opinion or disclaimer of opinion, he shall describe other matters which he is aware that would have required a modification.

Form and Content of Modified Report

Amendments in the opinion paragraph

- Use the heading- “Qualified Opinion”, “Adverse Opinion” or “Disclaimer of Opinion”
- Must use the phrases- “with the foregoing explanation” or “subject to” or “expect that”
- Where a qualified opinion is issued due to material misstatement the auditor shall state in the opinion paragraph that expect for the matters described in the basis of qualified opinion, the financial statements have been prepared, in all material respects, in accordance with the applicable financial reporting framework
- When modification arises from inability to obtain sufficient appropriate audit evidence, the auditor shall use the corresponding phrase “ except for possible effects of the matter(S).....” For the modified opinion

Form and Content of Modified Report

Amendments in the opinion paragraph

- When issuing an adverse opinion, the auditor shall state:
 - That the financial statement **DO NOT PRESENT** a true and fair view, or
 - The financial statements have **NOT** been prepared, in all material respects, in accordance with the applicable financial reporting framework
- When the auditor disclaims an opinion due to inability to obtain sufficient appropriate audit evidence, he shall state:
 - Because of the significance of the matters(S) described in the basis for disclaimer of opinion paragraph, the auditor has **NOT** been able to obtain sufficient appropriate audit evidence
 - The auditor does **NOT** express an opinion on the financial statements.

Form and Content of Modified Report

Amendments in the Auditors' responsibility paragraph

- In case of Qualified opinion or adverse opinion, the auditor shall state that he believes that the audit evidence is sufficient and appropriate to provide a basis for his **MODIFIED audit opinion**
- In case of disclaimer of opinion due to inability to obtain sufficient appropriate audit evidence:
 - The auditor shall amend the introductory paragraph to state that he was engaged to audit the financial statements.
 - He shall amend the auditors' responsibility paragraph and scope to include the following "because of the matters(s) described in the Basis for Disclaimer of Opinion paragraph, we have not been able obtain sufficient appropriate audit evidence to provide a basis for our audit opinion.

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Thank You!!

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