

## PROPOSED INTERNATIONAL STANDARD ON AUDITING 705

~~(Derived from ISA 701)~~

### MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT

(Effective for auditors' reports dated on or after [December 31, 2006])

**[MARKUP FROM EXPOSURE DRAFT]**

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Appendix: Examples of Auditors' Reports with Modifications to the Opinion

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International Standard on Auditing (ISA) 705, “Modifications to the Opinion in the Independent Auditor’s Report” should be read in the context of the “Preface to the International Standards on Quality Control, Auditing, Assurance and Related Services,” which sets out the application and authority of ISAs.

## Introduction

1. This International Standard on Auditing (ISA) establishes standards and provides guidance on:
  - (a) Circumstances that may result in a modification to the auditor’s opinion on the financial statements;<sup>‡</sup>
  - (b) The type of opinion appropriate in the circumstances;<sup>‡</sup> and
  - (c) The content of the auditor’s report when the auditor’s opinion is modified.
  
2. ISA 700 (Revised), “The Independent Auditor’s Report on a Complete Set of General Purpose Financial Statements,” establishes standards and provides guidance on the ~~independent~~ auditor’s report when the auditor is able to express an unmodified opinion on issued as a result of an audit of a complete set of general purpose financial statements prepared in accordance with a financial reporting framework designed to achieve fair presentation. The standards and guidance in this ISA are to be applied when the auditor modifies the opinion paragraph in the auditor’s report when engaged to report under ISA 700 (Revised). The Appendix to this ISA provides illustrative reports (based on the form and content of the auditor’s report as set out in ISA 700 (Revised)) where the auditor’s opinion is modified.
  
3. [Proposed] ISA 800/701, “The Independent Auditor’s Report on Other Historical Financial Information~~Special Purpose Audit Engagements~~,” establishes standards and provides guidance on the ~~independent~~ auditor’s report when the auditor is able to express an unmodified opinion on issued as a result of an audit of historical financial information other than (a) a complete set of general purpose financial statements prepared in accordance with a financial reporting framework designed to achieve fair presentation, and (b) summary audited financial statements. The standards and guidance in this ISA are to be adapted as necessary in the circumstances of an engagement to report under [Proposed] ISA 701 when the auditor modifies the opinion.:
  - ~~(a) A complete set of financial statements prepared in accordance with an other comprehensive basis of accounting;~~
  - ~~(b) A component of a complete set of general purpose or special purpose financial statements, such as a single financial statement, specified accounts, elements of accounts, or items in a financial statement;~~
  - ~~(c) Compliance with contractual agreements; and~~
  - ~~(d) Summarized financial statements.<sup>‡</sup>~~

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<sup>‡</sup> ~~The IAASB is currently revising ISA 800 to expand its scope to cover auditors’ reports on historical financial information other than a complete set of general purpose financial statements prepared in accordance with a financial reporting framework designed to achieve fair presentation, which is covered in ISA 700 (Revised). The proposed ISA 705 applies to engagements that fall within ISA 700 (Revised) and those that will fall within the proposed revised ISA 800. On finalization of the proposed revised ISA 800 (expected to be exposed for public comment later this year), this paragraph will be amended to conform to ISA 800 (Revised).~~

4. ~~Both ISA 700 (Revised) and ISA 800 address circumstances when the auditor is able to express an unmodified opinion and no other changes to the auditor’s report are necessary. The standards and guidance in this ISA are to be applied in circumstances when the auditor modifies the opinion paragraph in the auditor’s report issued as a result of an audit of a complete set of general purpose financial statements or a special purpose audit engagement. This ISA does not apply to engagements covered by [Proposed] ISA 800, “The Independent Auditor’s Report on Summary Audited Financial Statements.” [Proposed] ISA 800 establishes standards and provides guidance when the auditor modifies the opinion paragraph in the auditor’s report issued as a result of an audit of summary audited financial statements. The illustrative reports in this ISA (see Appendix) are based on the form and content of the auditor’s report on a complete set of general purpose financial statements.~~
  
5. ~~In contrast to this ISA, which addresses modifications to the auditor’s opinion, [p]Proposed] ISA 706, “Emphasis of Matter Paragraphs and Other Matters Paragraphs in the Independent Auditor’s Report,” establishes standards and provides guidance when the auditor’s considers report is amended to includeing an emphasis of matter paragraph or an other matters paragraph in the auditor’s report, without affecting the auditor’s opinion on the financial statements.~~
  
6. ~~ISA 200, “Objective and General Principles Governing an Audit of Financial Statements,” states that the objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. The auditor evaluates the conclusions drawn from the audit evidence obtained as a basis for forming an opinion on the financial statements.~~
  
- 76. The auditor should modify the opinion in the auditor’s report when:**
  - (a) **The auditor concludes that, based on the audit evidence obtained, the financial statements are not free from material misstatement due to a disagreement with management and, accordingly, are not prepared, in all material respects, in accordance with the anapplicable financial reporting framework; or**
  - (b) **The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements are free from material misstatement.**

## **Circumstances Resulting in a Determining the Type of Modification to the Auditor's Opinion**

~~8. In forming the opinion on the financial statements, as described in paragraph 6, the auditor evaluates whether the financial statements have been prepared and presented in accordance with the specific requirements of the applicable financial reporting framework. The auditor expresses a modified opinion in the auditor's report on the financial statements when:~~

- ~~(a) The auditor concludes that, based on the audit evidence obtained, the financial statements are not free from material misstatement due to a disagreement with management<sup>2,3</sup> about *[(i) TO (iii) MOVED TO PARAGRAPH 17]*~~
- ~~(b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements are free from material misstatement (also referred to as a limitation on the scope of the audit).~~

~~97. This ISA establishes three types of modified opinions, namely, a qualified opinion, an adverse opinion, and a disclaimer of opinion, the choice of which will depend upon:~~

- ~~(a) Whether there is a disagreement with management or an inability to obtain sufficient appropriate audit evidence; and~~
- ~~(b) †The auditor's judgment about the materiality and pervasiveness of the matter giving rise to the modification.~~

### *Disagreements with Management*

- ~~(a) The auditor expresses a qualified opinion (see paragraph 25) when the auditor concludes that the effect of any disagreement with management, while material, is not pervasive; accordingly, except for the matter giving rise to the modification, the financial statements are prepared in accordance with the applicable financial reporting framework and are not misleading; thus they do not require an adverse opinion.~~
- ~~(b) The auditor expresses an adverse opinion (see paragraph 28) when the auditor concludes that the effect of a disagreement with management is material and pervasive to the financial statements such that a qualified opinion is not adequate to disclose the misleading nature of the financial statements.~~

### *Inability to Obtain Sufficient Appropriate Audit Evidence*

- ~~(c) The auditor expresses a qualified opinion (see paragraph 25) when the auditor concludes that the possible effect of an inability to obtain sufficient appropriate~~

<sup>2</sup> ~~— A disagreement with management also encompasses the instance where management acknowledges that the financial statements contain a departure from the applicable financial reporting framework but management refuses to amend the financial statements for reasons such as cost-benefit considerations.~~

<sup>3</sup> ~~— The term "management" used in this ISA describes those responsible for the preparation and presentation of the financial statements. Other terms may be appropriate depending on the legal framework in the particular jurisdiction. For example, in some jurisdictions, the appropriate reference may be to those charged with governance (for example, the directors).~~

~~audit evidence, while material, in the auditor’s judgment could not be pervasive; therefore, the financial statements are not misleading and do not require a disclaimer of opinion. This may be the case when it is possible to determine and clearly describe in the auditor’s report which financial statement line items are or may be affected by the inability to obtain sufficient appropriate audit evidence.~~

~~(d) The auditor expresses a disclaimer of opinion (see paragraph 31) when the possible effect of an inability to obtain sufficient appropriate audit evidence is material and pervasive to the financial statements such that the auditor is unable to express an opinion on the financial statements.~~

~~See paragraph 23 for a discussion of materiality and paragraph 24 for a discussion of pervasiveness.~~

108. The table below illustrates how the auditor’s judgment about the nature, materiality and pervasiveness of the matter giving rise to the modification affects the type of opinion to be expressed.

<p style="text-align: right;">Affects or Possibly Affects the Financial Statements</p> <p>Nature of Matter Giving Rise to the Modification</p>	<p>Materially <u>but not</u> <u>Pervasively</u></p>	<p>Materially and Pervasively</p>
<p>Disagreement with <u>M</u>anagement</p>	<p><u>A</u> Qualified <u>Q</u>opinion (See paragraph 25)</p>	<p><u>B</u> Adverse <u>Q</u>opinion (See paragraph 28)</p>
<p>Inability to <u>Q</u>btain <u>S</u>ufficient <u>A</u>ppropriate <u>A</u>udit <u>E</u>evidence</p>	<p><u>C</u> Qualified <u>Q</u>opinion (See paragraph 25)</p>	<p><u>D</u> Disclaimer of <u>Q</u>opinion (See paragraph 31)</p>

Materiality

~~239.~~ [Proposed] ISA 320 (Revised) discusses the factors the auditor considers in determining the materiality of a matter and the importance of considering not only the financial magnitude of the matter but also ~~the-its~~ qualitative aspects ~~of the matter~~. ~~The circumstances related to some misstatements may cause the auditor to evaluate them as material, individually or when considered together with other identified misstatements, even if they are of a lower level than the auditor had determined to be material when establishing the overall audit strategy. With respect to a misstatement, C~~ircumstances that may affect the auditor's evaluation of its materiality include, for example, the extent to which the misstatement affects compliance with regulatory requirements and debt covenants, or other contractual requirements.

Pervasive Effect of a Disagreement with Management or an Inability to Obtain Sufficient Appropriate Audit Evidence

~~10.~~ The effect of a disagreement with management about one or more matters pertaining to the financial statements is pervasive when the matter or matters affect the financial statements to such an extent that the financial statements as a whole are misleading.<sup>4</sup> For example, ~~w~~When a disagreement with management relates to multiple departures from the applicable financial reporting framework and those departures affect multiple specific elements, accounts or items in the financial statements ~~line items~~, the financial statements as a whole may be misleading because of the cumulative effect of the departures.

~~11.~~ The possible effect of an inability to obtain sufficient appropriate audit evidence about one or more matters pertaining to the financial statements is pervasive when, in the auditor's judgment, the matter or matters affect, or could affect, the financial statements to such an extent that the auditor is unable to form an opinion on the financial statements as a whole.

**Disagreement with Management**Qualified Opinion

~~124.~~ **The auditor should express a qualified opinion when the auditor concludes that the effect of a disagreements with management ~~are-is~~ material, but not pervasive, to the financial statements. ~~When disagreements with management are material and pervasive to the financial statements, the auditor should express an adverse opinion. As discussed in paragraph 8(a), the auditor may disagree with management about the following matters:~~**

- ~~•The acceptability of selected accounting policies within the financial reporting framework;~~

<sup>4</sup> Section 110 of the IFAC *Code of Ethics for Professional Accountants* (Revised June 2005) requires a professional accountant not to be associated with reports, returns, communications or other information where they believe that the information (a) contains a materially false or misleading statement, (b) contains statements or information furnished recklessly, or (c) omits or obscures information required to be included where such omission or obscurity would be misleading, unless the professional accountant provides a modified report in respect of the information.

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

~~2613.~~ The auditor ~~ordinarily~~ expresses a qualified opinion when the effect of a disagreement with management, ~~while material but not pervasive; or inability to obtain sufficient appropriate audit evidence~~

- (a) ~~Can be clearly explained in the auditor’s report (for example, by quantifying the financial statement effects of an overstatement of cash, revenues, or equity); and~~
- (b) ~~Does not result in financial statements that are misleading<sup>5</sup> as a whole.~~

~~(See Example Report 1 in the Appendix for an example of illustrates a qualified opinion due to a disagreement with management and Example Reports 4 and 5 for examples of qualified opinions due to an inability to obtain sufficient appropriate audit evidence.)~~

*Adverse Opinion*

**14. The auditor should express an adverse opinion when the auditor concludes that the effect of a disagreement with management is not only material but also pervasive to the financial statements.**

~~2915.~~ ~~When~~ ~~The auditor will ordinarily be able to explain the effect of a disagreement with management in the auditor’s report even when the effect of the disagreement is not only material but also pervasive. In some circumstances, however, it is may not be possible or practicable for the auditor to determine the extent to which specific elements, accounts or items in the financial statements line items are affected or may be affected by thea disagreement with management. In these circumstances, it may be difficult impracticable or impossible for the auditor to explain in the auditor’s report the effect of the disagreement with management on the financial statements. For example, the disagreement may arise in respect of the failure to apply an accounting policy for provision for losses on long-term contracts. In this situation, it may not be practicable for the auditor to determine the extent to which specific elements, accounts or items such as provision for foreseeable losses on contracts, work-in-progress, net income, income tax, equity and any associated disclosures, are, or may be, affected over the relevant reporting periods. In such situations, the auditor ordinarily expresses an adverse opinion.~~

16. Example Report 2 in the Appendix illustrates an adverse opinion due to a disagreement with management.

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<sup>5</sup> Section 110 of the IFAC Code of Ethics for Professional Accountants (Revised June 2005) requires a professional accountant not to be associated with reports, returns, communications or other information where they believe that the information (a) contains a materially false or misleading statement, (b) contains statements or information furnished recklessly, or (c) omits or obscures information required to be included where such omission or obscurity would be misleading, unless the professional accountant provides a modified report in respect of the information.

Nature of a Disagreement with Management

17. A disagreement with management may arise in relation to:

- (a) The ~~acceptability~~appropriateness of selected accounting policies;
- (b) The application of the selected accounting policies; or
- (c) The appropriateness or adequacy of disclosures in the financial statements.

18. The term “disagreement with management” ~~It~~ also encompasses the instance where management acknowledges that the financial statements contain a material departure from the applicable financial reporting framework but management refuses to amend the financial statements for any reasons ~~such as, including~~ cost-benefit considerations.

Acceptability-Appropriateness of Selected Accounting Policies

192. Disagreements with management about the ~~acceptability~~appropriateness of the ~~selected~~ accounting policies management has selected may arise when:

- The selected accounting policies are not consistent with the applicable financial reporting framework~~;~~;
- The selected accounting policies are not appropriate in the circumstances and, accordingly, the overall presentation of~~;~~ and disclosures in~~;~~ the financial statements are not consistent with the auditor’s understanding of (a) the entity and its environment and (b) the applicable financial reporting framework;
- Because of the accounting policies selected by management, the financial statements, including the ~~note~~ disclosures, do not faithfully represent the underlying transactions and events in a manner that gives a true and fair view of (or presents fairly, in all material respects); the information in the financial statements.

1320. Where the entity has changed its selection of significant accounting policies, the auditor considers the reasons for the change and whether it is appropriate in the circumstances. Financial reporting frameworks often contain requirements for the accounting for~~;~~ and disclosure of~~;~~ changes in accounting policies. Where the entity has not complied with these requirements, the auditor considers whether this constitutes a material departure from the requirements of the applicable financial reporting framework, and the effect that such departure may have on the auditor’s opinion.

Application of the Selected Accounting Policies

214. Disagreements with management about the application of the selected accounting policies may arise when:

- Management has not applied the selected accounting policies consistently with the financial reporting framework, including applying or has not applied the selected accounting policies consistently between periods ~~and or~~ to similar transactions and events (consistency in application); or

- Based on the audit evidence obtained, the auditor has identified a misstatement of the financial statements due to the method of application of a selected accounting policy (error in application). This may arise when there is a disagreement with management about the underlying facts and circumstances to which the selected accounting policy ~~ies are~~ is applied (for example, a disagreement about estimates for pension liabilities).

~~15. The method of application of selected accounting policies may give rise to misstatements. [Proposed] ISA 320 (Revised), “Materiality in the Identification and Evaluation of Misstatements,” provides guidance on materiality and how it is used in the identification and evaluation of misstatements when performing an audit of financial statements.~~

### Appropriateness or Adequacy of Disclosures in the Financial Statements

~~1622.~~ Disagreements with management about the appropriateness or adequacy of disclosures in the financial statements may arise when ~~the financial statements:~~

- ~~(a) The disclosures present information that is not relevant, reliable, comparable or understandable; or~~
- ~~(b) The financial statements do not include all of the disclosures required by the applicable financial reporting framework, or~~
- ~~(b) do not provide sufficiently clear disclosures to enable users to understand the effect of material transactions and events on the information conveyed in the financial statements, for example, in the case of financial statements prepared in accordance with International Financial Reporting Standards (IFRSs), the effect on the entity’s financial position, financial performance, and cash flows.~~

### **Inability to Obtain Sufficient Appropriate Audit Evidence**

#### Qualified Opinion

~~1723.~~ **The auditor should express a qualified opinion w**When the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, about one or more matters that are or could be material, but in the auditor’s judgment are not pervasive, to and the possible effect on the financial statements of that inability is material but not pervasive, the auditor should express a qualified opinion. LAST SENTENCE MOVED TO PARAGRAPH 26.

24. The auditor expresses a qualified opinion when:

- ~~(a) It is possible to determine and clearly describe in the auditor’s report which specific elements, accounts or items in the financial statements ~~line items~~ are, or may be, affected by the inability to obtain sufficient appropriate audit evidence; and~~
- ~~(b) Such inability does not impair the auditor’s ability to form an opinion on the financial statements as a whole.~~

~~25. (See Example Report 1 in the Appendix for an example of a qualified opinion due to a disagreement with management and Example Reports 43 and 5 in the Appendix for examples of illustrates a qualified opinions due to an inability to obtain sufficient appropriate audit evidence.)~~

### Disclaimer of Opinion

~~26. If such matters are or could be When the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the possible effect on the financial statements of that inability is not only material but also and pervasive, to the financial statements, the auditor should express a disclaimer of an opinion on the financial statements.~~

~~327. The auditor ordinarily, when the possible effect of an inability to obtain sufficient appropriate audit evidence is not only material but also pervasive, expresses a disclaimer of opinion when it is will not be possible for the auditor to determine which specific elements, accounts or items in the financial statements line items are, or may be, affected by an inability to obtain sufficient appropriate audit evidence, and a Accordingly, it may be difficult or impossible for the auditor to clearly describe in the auditor's report the effect of the inability on the financial statements.~~

~~28. In some circumstances, however, the auditor may be able to describe the possible effect of an inability to obtain sufficient appropriate audit evidence that is not only material but also pervasive when that possible effect is clearly confined to a limited number of specific elements, accounts or items in the financial statements.~~

~~29. Example Report 4 in the Appendix illustrates a disclaimer of opinion due to an inability to obtain sufficient appropriate audit evidence.~~

### Possible Consequences of Multiple Uncertainties

~~303. The existence of one or more significant material uncertainties ordinarily does not, in itself, result in an inability for the auditor to form an opinion. If the auditor concludes that sufficient appropriate audit evidence has been obtained to support management's assertions about each of the uncertainties and their presentation and disclosure in the financial statements, an unmodified opinion is appropriate, regardless of the cumulative effect of the uncertainties. The auditor may highlight these uncertainties through an emphasis of matter paragraph in the auditor's report (see [proposed] ISA 706).~~

~~31. In extreme cases involving multiple uncertainties that have, or could have, a material and pervasive effect on the financial statements, however, the auditor may, however, be unable to obtain sufficient appropriate audit evidence regarding management's assertions about these uncertainties or their presentation and disclosure in the financial statements conclude that the cumulative nature and possible effect of the multiple uncertainties are such that it is not possible to form an opinion and, accordingly In such cases, the auditor expresses a disclaimer of an opinion.~~

### Nature of an Inability to Obtain Sufficient Appropriate Audit Evidence

32. The auditor's inability to obtain sufficient appropriate audit evidence (also referred to as a limitation on the scope of the audit) may arise from:

- (a) Circumstances beyond the control of the entity;
- (b) Circumstances relating to the nature or timing of the auditor's work; or
- (c) Limitations imposed by management.

33. The auditor may consider that an inability to perform a specific procedure does not constitute a scope limitation if the auditor is able to obtain sufficient appropriate audit evidence by performing alternative procedures. If performing alternative procedures is not possible, the auditor will not be able to obtain sufficient appropriate audit evidence and, accordingly, qualifies the opinion or disclaims an opinion. Limitations imposed by management may have other implications for the audit, for example, the auditor's assessment of fraud risks and consideration of engagement continuance.

~~1834. The auditor's inability to obtain sufficient appropriate audit evidence may be imposed by circumstances. For e~~Examples of circumstances beyond the control of the entity include;

~~□ THIS BULLET MOVED TO BECOME THE THIRD BULLET IN THE NEXT PARAGRAPH~~

- When the entity's accounting records have been destroyed due to a fire.
- When the entity's financial information has been irretrievably lost due to hardware failure of the entity's computerized information system.

~~The auditor considers whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence on which to base an unmodified opinion. If performing alternative procedures is not possible, the auditor will not be able to obtain sufficient appropriate audit evidence and, accordingly, qualifies the opinion or disclaims an opinion.~~

35. Examples of circumstances relating to the nature or timing of the auditor's work include:

- When the auditor determines that performing substantive procedures alone are not sufficient, but the entity's controls are not effective.
- When the entity is required to use the equity method of accounting for an associated entity, and the auditor is unable to obtain sufficient appropriate audit evidence about the latter's financial information to examine the application of the equity method.
- When the timing of the auditor's appointment is such that the auditor is unable to observe the counting of the physical inventories.

~~1936. The auditor's~~ Examples of an inability to obtain sufficient appropriate audit evidence may also be arising from a scope limitation imposed by management, ~~for example,~~ include:

- ~~w~~When management precludes the auditor from observing the counting of the physical inventory. ~~or~~
- When management prevents the auditor from requesting external confirmation of specific account balances.

Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence due to a Management-imposed Limitation After the Auditor has Accepted the Engagement

~~37~~<sup>20</sup>. ~~If, A~~after accepting ~~an~~<sup>the</sup> engagement, the auditor ~~may~~<sup>becomes</sup> aware that management has imposed a limitation on the scope of the audit which the auditor considers likely to result in the need to express a qualified opinion or ~~to a disclaimer of an~~ opinion on the financial statements. ~~Under those circumstances,~~ the auditor ~~should~~ requests the removal of that limitation. If management ~~does not remove the limitation~~<sup>refuses</sup>, the auditor ~~should~~ considers the implications for the ~~risk assessment~~<sup>audit</sup> and whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence on which to base an unmodified opinion. If performing alternative procedures is not possible, the auditor ~~will not be able to obtain sufficient appropriate audit evidence and, accordingly, should~~ qualify<sup>ies</sup> the opinion or disclaims an opinion.

~~38.~~ When the If, after the auditor has accepted the engagement, management imposes a scope limitation that the auditor is unable to overcome through the performance of alternative procedures, and the scope limitation relates to matters that are, or could be, not only material ~~and but also~~ pervasive to the financial statements, the auditor ~~may~~<sup>should</sup> consider resigning from the audit, where permitted by law or regulation.

~~39.~~ In certain circumstances, resignation from the audit may not be possible if the auditor is required to continue the audit engagement by law or regulation. This may be particularly the case for national audit agencies that are appointed to audit the financial statements of public sector entities. In such cases, the appropriate response for the auditor to a scope limitation imposed by management, the effect of which is not only material but also pervasive to the financial statements, is to disclaim an opinion on the financial statements.

## Determining the Type of Opinion

- ~~21.—Where there is a disagreement with management or an inability to obtain sufficient appropriate audit evidence, the auditor determines whether a modification to the opinion is necessary and, if so, what type of opinion (a qualified opinion, an adverse opinion, or a disclaimer of opinion) is appropriate in the circumstances.~~
- ~~22.—In deciding on the type of opinion, the auditor considers the materiality and pervasiveness of the matter giving rise to the modification to the opinion.~~
- ~~23.—THIS PARAGRAPH MOVED TO BECOME PARAGRAPH 9.~~
- ~~24.—In determining the pervasiveness of the effect of the disagreement with management or the inability to obtain sufficient appropriate audit evidence, the auditor considers the following:~~
- ~~(a) —The extent to which the disagreement with management or inability to obtain sufficient appropriate audit evidence can be (i) related to specific items in the financial statements and (ii) quantified (see paragraphs 27, 29 and 32).~~
  - ~~(b) —Whether the effect of the disagreement with management on the financial statements can be clearly explained in the auditor’s report so that the modification can address the incomplete or misleading nature of the financial statements (see paragraphs 26, 27, 29, 30 and 32).~~

~~The effect of a disagreement with management or an inability to obtain sufficient appropriate audit evidence is ordinarily considered to be pervasive when it materially affects the amounts and presentation of numerous financial statement line items. In certain circumstances, a single line item may comprise such a large percentage of the balance sheet, income statement, or cash flow statement; or otherwise be so fundamental to the financial statements, taken as a whole, that the auditor may conclude that a misstatement of that single line item is pervasive to the financial statements.~~

### *Qualified Opinion*

- ~~25.—The auditor should express a qualified opinion when the auditor concludes that an unmodified opinion cannot be expressed, but the effect of any disagreement with management or inability to obtain sufficient appropriate audit evidence, while material, in the auditor’s judgment is not pervasive to the financial statements; accordingly, neither an adverse opinion nor a disclaimer of opinion is required. CROSS-REFERENCES TO THE EXAMPLE REPORTS MOVED.~~
- ~~26.—PARAGRAPH MOVED TO BECOME PARAGRAPH 13.~~
- ~~27.—When a disagreement with management clearly relates to specific financial statement line items, and is readily quantifiable, for example, an overstatement of cash, revenues, or equity, the auditor will be able to clearly explain in the auditor’s report the effect of the disagreement with management on the financial statements. In such situations, if the~~

~~auditor concludes that the possible effect, while material, is not pervasive, the auditor ordinarily expresses a qualified opinion.~~

#### *Adverse Opinion*

~~28. The auditor should express an adverse opinion when the auditor concludes that the effect of a disagreement with management is material and pervasive to the financial statements and accordingly, a qualified opinion is not adequate to disclose the misleading or incomplete nature of the financial statements. (See Example Reports 2 and 3 in the Appendix.)~~

~~29. PARAGRAPH MOVED TO BECOME PARAGRAPH 15.~~

~~30. THE FIRST SENTENCE OF THIS PARAGRAPH MOVED TO BECOME THE EXAMPLE IN PARAGRAPH 10. Furthermore, as the number of financial statement line items affected by the disagreements with management increases, the more difficult it becomes to clearly explain in the auditor's report the effects of the disagreements. In such situations, the auditor ordinarily expresses an adverse opinion.~~

#### *Disclaimer of Opinion*

~~31. The auditor should express a disclaimer of opinion when the possible effect of an inability to obtain sufficient appropriate audit evidence is material and pervasive to the financial statements; accordingly, the auditor is unable to express a qualified opinion on the financial statements. (See Example Reports 6 and 7 in the Appendix.)~~

~~32. PARAGRAPH MOVED TO BECOME PARAGRAPH 27.~~

~~33. PARAGRAPH MOVED TO BECOME PARAGRAPHS 30 AND 31.~~

#### **Prohibition on Issuing a Piecemeal Opinions**

40. For the purpose of this ISA, a piecemeal opinion arises when the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements as a whole and, in the same report, expresses an unmodified opinion on one or more specific elements, accounts or items in the financial statements with respect to the same financial reporting framework.

~~34.1. A piecemeal opinion is an opinion where~~ **If the auditor has expressed an adverse opinion or a disclaimed opinion on the financial statements as a whole, the auditor should not express an unmodified opinion on one or more specific elements, accounts or items in the financial statements in the same report and with respect to the same financial reporting framework.**

42. Specific elements, accounts or items in the financial statements may include, for example, the revenue item in the income statement, or specific disclosures in the financial statements. Such a combination of supplementary an unmodified opinion on one or more of these specific elements, accounts or line items of a financial statement, and an adverse or disclaimed opinion on the financial statements as a whole, in the same

~~report and with respect to the same financial reporting framework. Such an opinion tends to overshadow or be contradictory the adverse opinion or the disclaimer of opinion and It is accordingly not permitted.~~

## ~~Communication with Those Charged with Governance~~

~~435. Prior to **issuing** the report, the auditor should communicate **with those charged with governance the** circumstances that lead to expected modifications to the opinion in the auditor's report, **and the proposed wording of the modification to those charged with governance.** This helps to ensure that~~

~~44. Such communication enables:~~

- ~~(a) Those charged with governance **are to be made** aware of the expected modification(s) and the reasons (or circumstances) for the modification(s) **before the financial statements are finalized;**~~
- ~~(b) **The auditor to agree** ~~There are no disputed the~~ facts in respect of the matter(s) giving rise to the expected modification(s), or **to confirm that** matters of disagreement with management **are confirmed** as such; and~~
- ~~(c) Those charged with governance **to** have an opportunity, where appropriate, to provide the auditor with further information and explanations in respect of the matter(s) giving rise to the expected modification(s).~~

## Form and Content of the Auditor's Report when the Opinion is Modified

### Basis for Modification Paragraph

~~3645.~~ Consistency in the auditor's report helps to promote the ~~readerusers's~~ understanding and to identify unusual circumstances when they occur. Accordingly, although uniformity in the wording of a modified opinion and in the description of the basis for the modification may not be possible, consistency in both the form and content of the auditor's report is desirable.

~~3746.~~ ~~ISA 700 (Revised) and ISA 800 require the auditor to include certain specific elements in the auditor's report when the auditor's opinion is unmodified. In addition to those specific elements, w~~**Whenever the auditor expresses a modified the opinion on the financial statements, the auditor should, in addition to the specific elements required by ISA 700 (Revised) and [proposed] ISA 701, include a paragraph in the auditor's report that provides:**

- ~~(a) A description of the matter giving rise to the modification; and~~
- ~~(b) A clear description of all the substantive reasons for the modification.;~~
- ~~(b) In the event of a disagreement with management about disclosures, a description of the omitted disclosures, unless impracticable or prohibited by law or regulation. It is not impracticable when the omitted disclosure information is reasonably available, and providing the information in the auditor's report does not require the auditor to assume management's responsibility for the preparation of~~

~~the financial statements. For example, it is not impracticable if the information can be obtained from the accounting records without the auditor (i) substantially increasing the effort that would normally be required to complete the audit, and (ii) assuming management's responsibility for preparing the financial statements. In those cases, the auditor includes the omitted information in the basis for modification paragraph of the auditor's report;~~

~~(e) In the event of a disagreement with management, a description and quantification of the principal effects on the financial statements of the matter giving rise to the modification, unless impracticable. If the principal effects are not reasonably quantifiable, the auditor's report should so state.~~

~~(d) In the event of an inability to obtain sufficient appropriate audit evidence, a description of the reason for the inability. (See paragraphs 17-20)~~

**The auditor should place ~~This paragraph should precede immediately before~~ the opinion paragraph in the auditor's report and use ~~should have~~ the heading "Basis for Qualified Opinion," "Basis for Adverse Opinion," or "Basis for Disclaimed~~r~~ of Opinion," as appropriate.**

47. If the modification results from a disagreement with management about a specific element, account or item in the financial statements, the auditor's description of the substantive reasons for the modification encompasses:

(a) Where the disagreement relates to part or all of a financial statement (for example, a cash flow statement) that has been omitted, or not provided to the required level of detail, a description of the nature of the omitted information; or

(b) Where the disagreement otherwise relates to:

(i) Specific amounts included, or not accounted for, in the financial statements, a description of the financial effects of the disagreement, unless impracticable (for example, the effects on income tax, net income and equity if inventory is overstated); or

(ii) Incorrect or misleading qualitative disclosures, an explanation of why the disclosures are incorrect or misleading.

48. If the modification results from an inability to obtain sufficient appropriate audit evidence, the auditor's description of the substantive reasons for the modification encompasses the reasons for the inability to obtain such audit evidence.

~~38. If the modification arises from a known or likely misstatement (see [proposed] ISA 320 (Revised)), the consequences of the misstatement are described in the basis for modification paragraph. For example, if inventory is overstated, tax, net income and equity will be affected as a consequence. When there is an inability to obtain sufficient appropriate audit evidence, the auditor may not be able to quantify the possible effects on the financial statements, and thus may not be able to include such information in the basis for modification paragraph.~~

~~349. The auditor describes in the basis for modification paragraph of the auditor’s report the reasons for all matters that require modifications to the opinion, and the effects thereof. For example, even when the auditor expresses an adverse opinion because the auditor concludes that the entity is not a going concern, the An adverse or disclaimed opinion does not justify the omission of a description of specific modifications for specific other identified matters that would require a modification, for example disagreements with management about the recognition, measurement, or disclosure of certain assets and liabilities; (for example, the existence of inventory). Accordingly, the auditor describes in the basis for modification paragraph the reasons for all matters that would require a modification to the opinion, and the effects thereof.~~

### **Modified Opinion Paragraph**

~~450. When the auditor modifies the audit opinion ~~is modified~~, the auditor should use opinion paragraph should have the heading “Qualified Opinion,” “Adverse Opinion,” or “Disclaimed ~~of~~ Opinion,” as appropriate, for the modified opinion paragraph.~~

~~51.~~ Inclusion of this paragraph heading makes it clear to the user that the auditor’s opinion is modified and indicates the type of modification.

~~4152.~~ When the auditor ~~expresses~~ esing a qualified opinion, the auditor should state in the modified opinion paragraph ~~should state~~ that, in the auditor’s opinion, except for the effects of the matter(s) described in the Basis for Qualified Opinion paragraph, the financial statements give a true and fair view (or “present fairly, in all material respects”) in accordance with the applicable financial reporting framework. When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor opinion should use the corresponding phrase “except for the possible effects of the matter(s) ...” for the modified opinion.

~~53.~~ Other phrases such as “with the foregoing explanation” or “subject to” are not sufficiently clear or forceful and are not used.

~~542.~~ When the auditor ~~expresses~~ esing an adverse opinion, the auditor should state in the modified opinion paragraph ~~should state~~ that, in the auditor’s opinion, because of the significance of the matter(s) described in the Basis for Adverse Opinion paragraph, the financial statements do not give a true and fair view (or “do not present fairly, ~~in all material respects~~”) in accordance with the applicable financial reporting framework.

~~4355.~~ When ~~expressing a the auditor disclaimer of an~~ opinion, the ~~auditor should state in the modified~~ opinion paragraph ~~should state that, in the auditor's opinion,~~ because of the significance of the matter(s) described in the Basis for Disclaimed ~~r~~ ~~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, the auditor does not express an opinion on the financial statements.

**Description of Auditor's Responsibility when there is an Inability to Obtain Sufficient Appropriate Audit Evidence Auditor Disclaims an Opinion**

~~44.~~ ~~When the auditor expresses a qualified opinion because of an inability to obtain sufficient appropriate audit evidence, the auditor should amend the description of the auditor's responsibility to state that, except for the matter described in the Basis for Qualified Opinion paragraph, the auditor conducted the audit in accordance with ISAs.~~

456. When the auditor ~~expresses a disclaimer of an~~ opinion, the auditor should amend ~~the introductory paragraph of the auditor's report to state that the auditor was engaged to audit the financial statements. The auditor should also amend the~~ description of the auditor's responsibility and the description of the scope of the audit to state only that ~~"the auditor's responsibility is to express an opinion on the financial statements based on the audit, b~~ Because of the matter(s) described in the Basis for Disclaimed ~~r~~ Opinion paragraph, however, the auditor was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion complete an audit in accordance with ISAs."

**Effective Date**

~~4657.~~ This ISA is effective for auditors' reports dated on or after [December 31, 2006].

## Appendix

### Examples of Auditors' Reports with Modifications to the Opinion

**Example Report 1: Auditor's report with a qualified opinion due to a disagreement with management – overstatement of inventories;** ~~¶~~**The effect of this disagreement with management is deemed to be material but not pervasive to the financial statements. The report also contains an emphasis of matter paragraph (see [proposed] ISA 706, “Emphasis of Matter Paragraphs and Other Matters Paragraphs in the Independent Auditor's Report”).**

#### INDEPENDENT AUDITOR'S REPORT

*[Appropriate Addressee]*

##### **Report on the Financial Statements<sup>6</sup>**

We have audited the accompanying financial statements of ABC Company, which comprise the balance sheet as at December 31, 20X1, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

##### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and ~~the~~ fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

##### *Auditor's Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit

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<sup>6</sup> The subheading “Report on the Financial Statements” is unnecessary in circumstances when the second subheading “Report on Other Legal and Regulatory Requirements” is not applicable.

procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.<sup>7</sup> An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

#### *Basis for Qualified Opinion*

The company's inventories are recognized in the balance sheet at ~~16xx~~ million EUR. ~~We do not agree with management regarding the amounts at which the inventories are stated. With effect from this reporting period, management has ceased to measure them at the lower of cost and net realizable value, which constitutes a departure from International Financial Reporting Standards. Had management measured the inventories at the lower of cost and net realizable value, an amount of xx million would have been required to write them down to~~ Based on the audit evidence obtained, we believe that an adjustment to inventories of 5 million EUR is required to recognize slow moving items at their net realizable value. ~~Cost of sales would have been increased by xx million, and income tax, net income and shareholders' equity would have been reduced by xx million, xx million and xx million. The tax effect of this adjustment is 1.5 million EUR. Accordingly, we believe that shareholders' equity and profit for the year are overstated by 3.5 million EUR~~ respectively.

#### *Qualified Opinion*

In our opinion, except for the effects of the matters described in the Basis for Qualified Opinion paragraph, the financial statements give a true and fair view of (or "present fairly, in all material respects") the financial position of ABC Company as of December 31, 20X1, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

#### *Emphasis of Matter*

~~We draw attention to a significant and unusual related party transaction disclosed in Note X to the financial statements, which includes an appropriate description of the company's sale of the office equipment division to a member of the company's management team for 100 million EUR.~~

### **Report on Other Legal and Regulatory Requirements**

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<sup>7</sup> In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances."

*[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]*

*[Auditor's signature]*

*[Date of the auditor's report]*

*[Auditor's address]*

~~Example Report 2: Auditor’s report with an adverse opinion due to a disagreement with management related to the going concern assumption; the effect of the disagreement with management is deemed to be material and pervasive to the financial statements.~~

~~INDEPENDENT AUDITOR’S REPORT~~

~~[Appropriate Addressee]~~

~~**Report on the Financial Statements**<sup>8</sup>~~

~~We have audited ... (remaining words are the same as illustrated in the introductory paragraph—see Example Report 1 above).~~

~~*Management’s Responsibility for the Financial Statements*~~

~~Management is responsible for ... (remaining words are the same as illustrated in the management’s responsibility paragraph—see Example Report 1 above).~~

~~*Auditor’s Responsibility*~~

~~Our responsibility is ... (remaining words are the same as illustrated in the paragraphs describing the auditor’s responsibility—see Example Report 1).~~

~~*Basis for Adverse Opinion*~~

~~As discussed in Note X to the financial statements, ABC Company’s financing arrangements expired and the amount outstanding was payable on December 31, 20X1. The company has been unable to re-negotiate or obtain replacement financing and is considering filing for bankruptcy. Based on the audit evidence obtained, we believe that the company will not be able to meet its obligations in the ordinary course of business. Accordingly, we do not agree with management’s preparation and presentation of the financial statements on a going concern basis. Had the financial statements been prepared on a liquidation basis of accounting, we believe that it would have had a significant negative effect on the company’s financial position and financial performance.~~

~~*Adverse Opinion*~~

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

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<sup>8</sup>—~~The subheading “Report on the Financial Statements” is unnecessary in circumstances when the second subheading “Report on Other Legal and Regulatory Requirements” is not applicable.~~

**~~Report on Other Legal and Regulatory Requirements~~**

~~[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]~~

~~[Auditor's signature]~~

~~[Date of the auditor's report]~~

~~[Auditor's address]~~

**Example Report 32: Auditor’s report with an adverse opinion due to a disagreement with management relating to the non-consolidation of a subsidiary. write-down of accounts receivable in the amount of 5 million EUR; the balance sheet total is 7 million EUR and the profit after tax is 0.3 million EUR. The effect of this disagreement with management is deemed to be not only both-material but also and-pervasive to the financial statements.**

## INDEPENDENT AUDITOR’S REPORT

[Appropriate Addressee]

### Report on the Financial Statements<sup>9</sup>

~~We have audited ... (remaining words are the same as illustrated in the introductory paragraph—see Example Report 1 above). We have audited the accompanying financial statements of ABC Company, which comprise the balance sheet as at December 31, 20X1, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.~~

### Management’s Responsibility for the Financial Statements

~~Management is responsible for ... (remaining words are the same as illustrated in the management’s responsibility paragraph—see Example Report 1 above). Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.~~

### Auditor’s Responsibility

~~Our responsibility is ... (remaining words are the same as illustrated in the paragraphs describing the auditor’s responsibility—see Example Report 1). Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.~~

~~An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making~~

<sup>9</sup> The subheading “Report on the Financial Statements” is unnecessary in circumstances when the second subheading “Report on Other Legal and Regulatory Requirements” is not applicable.

those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements 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 the entity's internal control.<sup>10</sup> An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

#### *Basis for Adverse Opinion*

~~The company's accounts receivable are recognized in the balance sheet at 6 million EUR. Based on the audit evidence obtained, we believe an adjustment to accounts receivable of 5 million EUR is required to recognize a receivable from XYZ Company that cannot be collected. The tax effect is 1.5 million EUR. Accordingly, we believe that shareholders' equity and profit for the year are overstated by 3.5 million EUR respectively.~~

As explained in Note X, with effect from this reporting period, the company ceased to consolidate the financial statements of its subsidiary. This investment is now 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 consolidated financial statements been prepared, the effect on the accompanying financial statements would have been material and pervasive. The audited financial statements of the subsidiary show that, while the company's proportionate share in the underlying book values is greater than the cost of investment, substantial losses have been incurred during the reporting period, of which the company's share on consolidation would amount to approximately xx million.

#### *Adverse Opinion*

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

#### **Report on Other Legal and Regulatory Requirements**

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<sup>10</sup> In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances."

*[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]*

*[Auditor's signature]*

*[Date of the auditor's report]*

*[Auditor's address]*

**Example Report 43: Auditor’s report with a qualified opinion due to the auditor’s inability to obtain sufficient appropriate audit evidence regarding an investment in a foreign affiliate.†** ~~The possible effect of the inability to obtain sufficient appropriate audit evidence can be clearly described in the auditor’s report and, while material, is not deemed to be pervasive to the financial statements.~~

## INDEPENDENT AUDITOR’S REPORT

*[Appropriate Addressee]*

### **Report on the Financial Statements<sup>11</sup>**

~~We have audited ... (remaining words are the same as illustrated in the introductory paragraph—see Example Report 1 above). We have audited the accompanying financial statements of ABC Company, which comprise the balance sheet as at December 31, 20X1, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.~~

### *Management’s Responsibility for the Financial Statements*

~~Management is responsible for ... (remaining words are the same as illustrated in the management’s responsibility paragraph—see Example Report 1 above). Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.~~

### *Auditor’s Responsibility*

~~Our responsibility is to express an opinion on these financial statements based on our audit. Except for the matter described in the Basis for Qualified Opinion paragraph, we conducted our audit ... (remaining words of the first two paragraphs are the same as in the first two paragraphs of the auditor’s responsibility—see Example Report 1 above).~~

~~We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.~~

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<sup>11</sup> The subheading “Report on the Financial Statements” is unnecessary in circumstances when the second subheading “Report on Other Legal and Regulatory Requirements” is not applicable.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements 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 the entity's internal control.<sup>12</sup> An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

#### *Basis for Qualified Opinion*

ABC Company's investment in XYZ Company, a foreign associate accounted for by the equity method, is recognized at ~~15xx~~ million ~~EUR~~ on the balance sheet as at December 31, 20X1, and ABC's share of ~~profit of XYZ's Company net income~~ is recognized at ~~1xx~~ million ~~EUR~~ in ~~the ABC's~~ income statement for the year ~~then ended December 31, 20X1~~. We were unable to obtain sufficient appropriate audit evidence about the carrying value of ABC's investment in XYZ as at December 31, 20X1 and ABC's share of XYZ's net income for the year because we were not given in relation to the financial information of XYZ Company because we were unable to obtain access to the accounting records, management, or the auditors of XYZ Company. We were not able to determine whether any adjustments might have been necessary to these amounts had we been able to obtain such access.

#### *Qualified Opinion*

In our opinion, except for the possible effects of the matters described in the Basis for Qualified Opinion paragraph, the financial statements give a true and fair view of (or "present fairly, in all material respects") the financial position of ABC Company as of December 31, 20X1, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

#### **Report on Other Legal and Regulatory Requirements**

*[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]*

*[Auditor's signature]*

<sup>12</sup> In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances."

*[Date of the auditor's report]*

*[Auditor's address]*

~~Example Report 5: Auditor’s report with a qualified opinion due to the auditor’s inability to obtain sufficient appropriate audit evidence; the possible effect of the inability to obtain sufficient appropriate audit evidence can be clearly described in the auditor’s report and, while material, is not deemed to be pervasive to the financial statements.~~

## INDEPENDENT AUDITOR’S REPORT

~~[Appropriate Addressee]~~

### ~~Report on the Financial Statements<sup>13</sup>~~

~~We have audited ... (remaining words are the same as illustrated in the introductory paragraph—see Example Report 1 above).~~

#### ~~Management’s Responsibility for the Financial Statements~~

~~Management is responsible for ... (remaining words are the same as illustrated in the management’s responsibility paragraph—see Example Report 1 above).~~

#### ~~Auditor’s Responsibility~~

~~Our responsibility is to express an opinion on these financial statements based on our audit. Except for the matter described in the Basis for Qualified Opinion paragraph, we conducted our audit ... (remaining words of the first two paragraphs are the same as in the first two paragraphs of the auditor’s responsibility—see Example Report 1 above)~~

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

#### ~~Basis for Qualified Opinion~~

~~The company’s accounting records for cash sales were not adequate for purposes of our audit and therefore there were no satisfactory audit procedures that we could perform to obtain reasonable assurance that all cash sales have been properly recorded. The company’s recorded sales, which total 1 million EUR, include 50,000 EUR in cash sales.~~

#### ~~Qualified Opinion~~

~~In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements give a true and fair view of (or “present fairly, in all material respects”) the financial position of ABC Company as of December 31, 20X1, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards~~

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<sup>13</sup>—~~The subheading “Report on the Financial Statements” is unnecessary in circumstances when the second subheading “Report on Other Legal and Regulatory Requirements” is not applicable.~~

**~~Report on Other Legal and Regulatory Requirements~~**

~~[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]~~

~~[Auditor's signature]~~

~~[Date of the auditor's report]~~

~~[Auditor's address]~~

~~Example Report 6: Auditor’s report with a disclaimer of opinion due to the auditor’s inability to obtain sufficient appropriate audit evidence with respect to inventory and accounts receivable; the auditor was unable to obtain sufficient appropriate audit evidence because management restricted the scope of the auditor’s procedures; the report also identifies a disagreement with management related to interest-bearing borrowings; the possible effect of the inability to obtain sufficient appropriate audit evidence is deemed to be material and pervasive to the financial statements.~~

## INDEPENDENT AUDITOR’S REPORT

*[Appropriate Addressee]*

### ~~Report on the Financial Statements<sup>14</sup>~~

~~We were engaged to audit the accompanying financial statements of ABC Company, which comprise the balance sheet as at December 31, 20X1, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.~~

#### *Management’s Responsibility for the Financial Statements*

~~Management is responsible for ... (remaining words are the same as illustrated in the management’s responsibility paragraph—see Example Report 1 above).~~

#### *Auditor’s Responsibility*

~~Because of the matter described in the Basis for Disclaimer of Opinion paragraph, we were not able to complete an audit in accordance with International Standards on Auditing.~~

#### *Basis for Disclaimer of Opinion*

~~The company’s management restricted us from observing the counting of the physical inventories and sending out requests for confirmation of accounts receivable to certain customers. The company’s records did not permit the application of alternative auditing procedures regarding the inventories and accounts receivable. Consequently, we were unable to obtain all the information and explanations we considered necessary to satisfy ourselves as to the existence of inventories and accounts receivable.~~

~~Furthermore, included in interest bearing borrowings, under non-current liabilities, are amounts totaling 5 million EUR that are due for settlement within the forthcoming fiscal year. International Accounting Standard 1, “Presentation of Financial Statements,” requires separate disclosure of amounts that are to be settled before and after the forthcoming fiscal year. Based on the latter, interest bearing~~

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<sup>14</sup>—The subheading “Report on the Financial Statements” is unnecessary in circumstances when the second subheading “Report on Other Legal and Regulatory Requirements” is not applicable.

~~borrowings would have been stated at 15 million EUR, short-term borrowings at 10 million EUR and current liabilities at 25 million EUR.~~

*~~Disclaimer of Opinion~~*

~~Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraphs above, 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 the financial statements.~~

**~~Report on Other Legal and Regulatory Requirements~~**

~~[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]~~

~~[Auditor's signature]~~

~~[Date of the auditor's report]~~

~~[Auditor's address]~~

**Example Report 47: Auditor’s report with a disclaimed~~r~~ of opinion due to the auditor’s inability to obtain sufficient appropriate audit evidence~~;~~; ~~e~~Completeness of accounting records cannot be substantiated due to lack of control over sales~~;~~; ~~t~~The possible effect of this inability to obtain sufficient appropriate audit evidence is deemed to be not only material ~~and~~but also pervasive to the financial statements.**

## INDEPENDENT AUDITOR’S REPORT

*[Appropriate Addressee]*

### **Report on the Financial Statements<sup>15</sup>**

We were engaged to audit the accompanying financial statements of ABC Company, which comprise the balance sheet as at December 31, 20X1, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

#### *Management’s Responsibility for the Financial Statements*

~~Management is responsible for ... (remaining words are the same as illustrated in the management’s responsibility paragraph — see Example Report 1 above).~~  
Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

#### *Auditor’s Responsibility*

Our responsibility is to express an opinion on these financial statements based on the audit. Because of the matter described in the Basis for Disclaimed~~r~~ of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion~~to complete an audit in accordance with International Standards on Auditing.~~

#### *Basis for Disclaimed~~r~~ of Opinion*

The Company’s sales are made entirely on a cash basis. The Company’s accounting records for cash sales were ~~not~~inadequate for the purposes of our audit and, ~~therefore,~~ there were no satisfactory audit procedures that we could have performed to obtain reasonable assurance that all cash sales ~~have been~~were properly recorded. As a result, we were unable to determine whether any adjustments would be required in respect of recorded or unrecorded sales, recorded or unrecorded cash

<sup>15</sup> The subheading “Report on the Financial Statements” is unnecessary in circumstances when the second subheading “Report on Other Legal and Regulatory Requirements” is not applicable.

receipts, and the elements making up the statements of income, changes in equity and cash flows.

*Disclaimed~~r~~-of Opinion*

Because of the significance of the matter described in the Basis for Disclaimed~~r~~-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 the financial statements.

**Report on Other Legal and Regulatory Requirements**

*[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]*

*[Auditor's signature]*

*[Date of the auditor's report]*

*[Auditor's address]*