



# AUDIT REPORTS

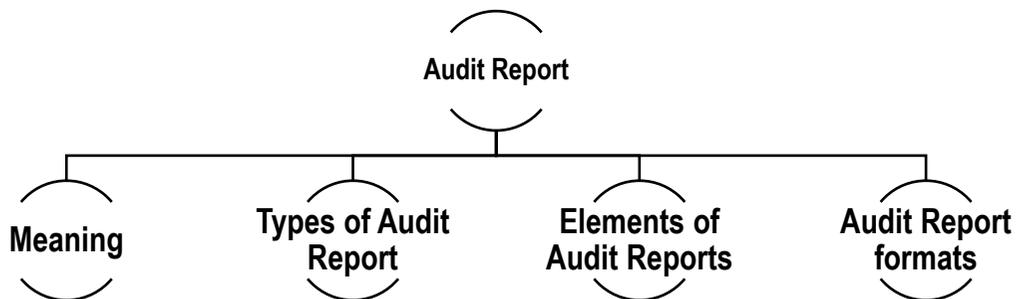


## LEARNING OUTCOMES

After studying this chapter, you will be able to:

- ❑ Understand the meaning and Different types of Audit Reports as per Standards of Auditing.
- ❑ Identify the different aspects of Reporting as per Standards of Auditing.
- ❑ Determine and apply knowledge of Reporting for further study and Professional Practice.

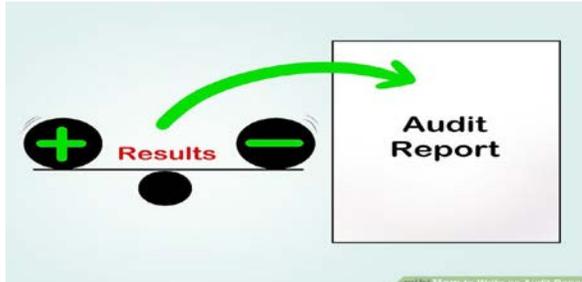
## CHAPTER OVERVIEW



## 1. INTRODUCTION



Assuming you are an auditor and have concluded the audit field work, your next step will be issuance of the audit report. An audit report is very important medium of communication i.e. auditor's expert views on the financial statements and it has a significant bearing on the credibility of such statements. By expressing views in the report, the auditor takes upon himself a great responsibility because a large number of stakeholders are likely to place reliance on the financial statements. Therefore, the auditor is necessarily required to be careful, vigilant, and objective in the matter of preparation of his report. The auditor should endeavor to keep his report as much simpler as possible but of course complying with the applicable reporting requirements and as much as the circumstances may permit.



## 2. THE AUDITOR'S REPORT ON FINANCIAL STATEMENTS

The SA 700 series is purely dedicated to the auditor report to be issued by the auditor. There are following SAs which you need to be aware of:

Particulars	Head	Purpose	Effective Date
SA-700 (Revised)	Forming an Opinion and Reporting on Financial Statements	<ul style="list-style-type: none"> <li>Forming opinion on the financial statements.</li> <li>Form and content of the audit report.</li> </ul>	1 <sup>st</sup> April 2017
SA-701 (newly introduced)	Communicating Key Audit Matters in the Independent Auditor's Report	<ul style="list-style-type: none"> <li>To enhance the communicative value of the auditor's report by providing greater transparency about the audit that was performed.</li> <li>To assist the user in</li> </ul>	1 <sup>st</sup> April 2017

		understanding those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period.	
SA-705 (Revised)	Modifications to the Opinion in the Independent Auditor's Report	<ul style="list-style-type: none"> <li>To issue an appropriate audit report when the auditor considers the modification in an audit report is necessary.</li> <li>To deal with the revised form and content when the modification of the opinion take place.</li> </ul>	1 <sup>st</sup> April 2017
SA-706 (Revised)	Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report	<p><b>To draw user's attention to a matter or matters:-</b></p> <ul style="list-style-type: none"> <li>Presented or disclosed in the financial statements and which is fundamental for the understanding of the user, or</li> <li>Not presented or disclosed in the financial statement and which is relevant for the understanding of the user.</li> </ul>	1 <sup>st</sup> April 2017



### 3. SA-700, "FORMING AN OPINION AND REPORTING ON THE FINANCIAL STATEMENTS"

It deals with the auditor's responsibility to form an opinion on the financial statements. It also deals with the form and content of the auditor's report issued as a result of an audit of financial statements.

**Objective:** As per SA 700 the objectives of the auditor are:

- (a) To form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and
- (b) To express clearly that opinion through a written report.

### 3.1 Purpose

The requirements of this SA are aimed at addressing an appropriate balance between the need for consistency and comparability in auditor reporting globally and the need to increase the value of auditor reporting by making the information provided in the auditor's report more relevant to users. This SA promotes consistency in the auditor's report, but recognizes the need for flexibility to accommodate particular circumstances of individual jurisdictions. Consistency in the auditor's report, when the audit has been conducted in accordance with SAs, promotes credibility in the global marketplace by making more readily identifiable those audits that have been conducted in accordance with globally recognized standards. It also helps to promote the user's understanding and to identify unusual circumstances when they occur.

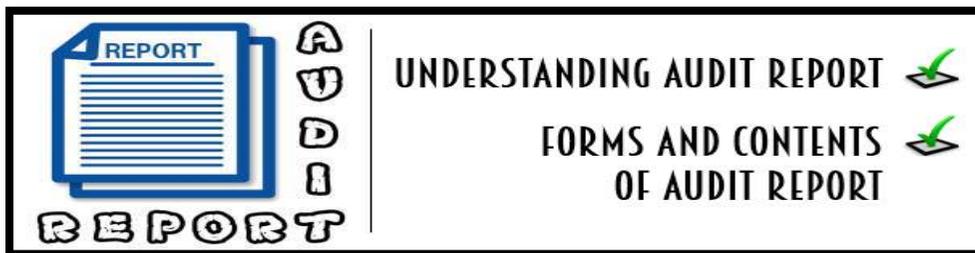
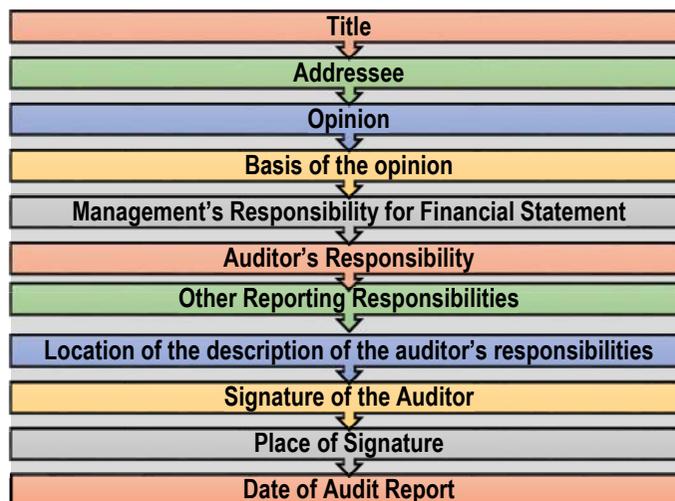


Image: Understanding Audit report, Forms and contents of Audit Report\*

### 3.2 Basic Elements of the Auditor's Report

As per SA 700 "Forming an opinion and reporting on financial statements", the auditor's report includes the following basic elements, which ordinarily includes in case of Auditors' Report for Audits Conducted in Accordance with Standards on Auditing:



\* Source : [accountlearning.com](http://accountlearning.com)

1. **Title:** The auditor's report shall have a title that clearly indicates that it is the report of an independent auditor.



"Independent Auditor's Report," distinguishes the independent auditor's report from reports issued by others.

2. **Addressee:** The auditor's report shall be addressed as required by the circumstances of the engagement.



The report could be addressed to the Members of the Company in case of general purpose (statutory) financial statements and to the Board of Directors in case of special purpose financial statements.

3. **Auditor's Opinion:** The first section of the auditor's report shall include the auditor's opinion, and shall have the heading "Opinion."

**The Opinion section of the auditor's report shall also:**

- (a) Identify the entity whose financial statements have been audited;
- (b) State that the financial statements have been audited;
- (c) Identify the title of each statement comprising the financial statements;
- (d) Refer to the notes, including the summary of significant accounting policies; and
- (e) Specify the date of, or period covered by, each financial statement comprising the financial statements.

When expressing an unmodified opinion on financial statements prepared in accordance with a fair presentation framework, the auditor's opinion shall, unless otherwise required by law or regulation, use one of the following phrases, which are regarded as being equivalent:

- (i) In our opinion, the accompanying financial statements present fairly, in all material respects, [...] in accordance with [the applicable financial reporting framework]; or
- (ii) In our opinion, the accompanying financial statements give a true and fair view of [...] in accordance with [the applicable financial reporting framework].

When expressing an unmodified opinion on financial statements prepared in accordance with a compliance framework, the auditor's opinion shall be that the accompanying financial statements are prepared, in all material respects, in accordance with [the applicable financial reporting framework].

If the reference to the applicable financial reporting framework in the auditor's opinion is not to Accounting Standards, the auditor's opinion shall identify the origin of such other framework.

4. **Basis for Opinion:** The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion", that:

(a) States that the audit was conducted in accordance with Standards on Auditing;
(b) Refers to the section of the auditor's report that describes the auditor's responsibilities under the SAs;
(c) Includes a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit, and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements. The statement shall refer to the Code of Ethics issued by ICAI
(d) States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

5. **Going Concern:** Where applicable, the auditor shall report in accordance with SA 570.
6. **Key Audit Matters:** For audits of complete sets of general purpose financial statements of listed entities, the auditor shall communicate key audit matters in the auditor's report in accordance with SA 701.

When the auditor is otherwise required by law or regulation or decides to communicate key audit matters in the auditor's report, the auditor shall do so in accordance with SA 701.

7. **Responsibilities for the Financial Statements:** The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements." The auditor's report shall use the term that is appropriate in the context of the legal framework applicable to the entity and need not refer specifically to "management". In some entities, the appropriate reference may be to those charged with governance.

**This section of the auditor's report shall describe management's responsibility for:**

(a) Preparing the financial statements in accordance with the applicable financial reporting framework, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and

(b) Assessing the entity's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate as well as disclosing, if applicable, matters relating to going concern. The explanation of management's responsibility for this assessment shall include a description of when the use of the going concern basis of accounting is appropriate.

This section of the auditor's report shall also identify those responsible for the oversight of the financial reporting process, when those responsible for such oversight are different from those who fulfill the responsibilities described in next paragraph. In this case, the heading of this section shall also refer to "Those Charged with Governance" or such term that is appropriate in the context of the legal framework applicable to entity.

When the financial statements are prepared in accordance with a fair presentation framework, the description of responsibilities for the financial statements in the auditor's report shall refer to "the preparation and fair presentation of these financial statements" or

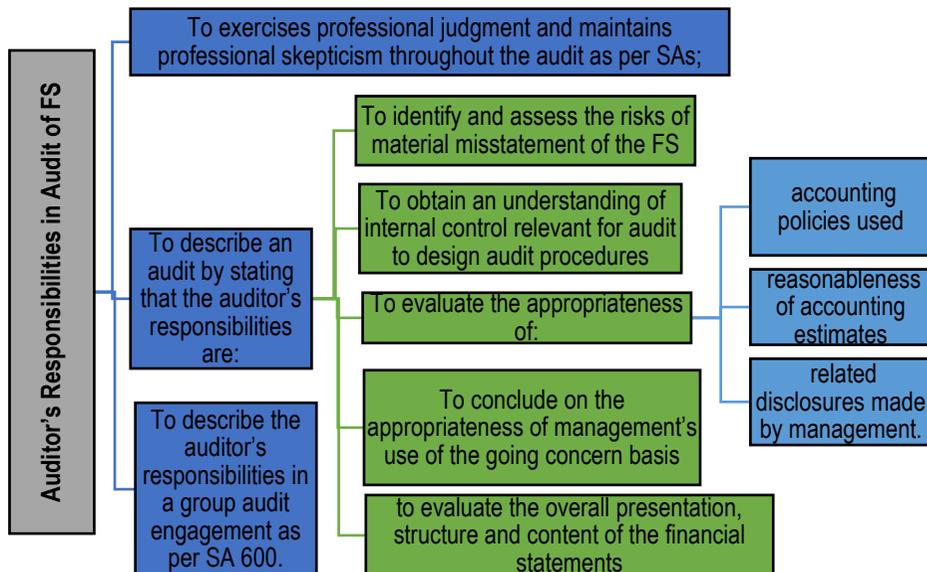
“the preparation of financial statements that give a true and fair view,” as appropriate in the circumstances.

**8. Auditor’s Responsibilities for the Audit of the Financial Statements:** The auditors report shall include a section with the heading “Auditor’s Responsibilities for the Audit of the Financial Statements.”

**(I) This section of the auditor’s report shall:**

<p><b>(a) State that the objectives of the auditor are to:</b></p> <ul style="list-style-type: none"> <li>(i) Obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error; and</li> <li>(ii) Issue an auditor’s report that includes the auditor’s opinion.</li> </ul>
<p><b>(b) State that reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with SAs will always detect a material misstatement when it exists; and</b></p>
<p><b>(c) State that misstatements can arise from fraud or error, and either:</b></p> <ul style="list-style-type: none"> <li>(i) Describe that they are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements; or</li> <li>(ii) Provide a definition or description of materiality in accordance with the applicable financial reporting framework.</li> </ul>

**(II) The Auditor’s Responsibilities for the Audit of the Financial Statements section of the auditor’s report shall further:**



- (a) State that, as part of an audit in accordance with SAs, the auditor exercises professional judgment and maintains professional skepticism throughout the audit; and
- (b) Describe an audit by stating that the auditor's responsibilities are:

- (i) **To identify and assess the risks of material misstatement of the financial statements**, whether due to fraud or error; to design and perform audit procedures responsive to those risks; and to obtain audit evidence that is sufficient and appropriate to provide a basis for the auditor's opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- (ii) **To obtain an understanding of internal control relevant to the audit in order to design audit procedures** that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. In circumstances when the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, the auditor shall omit the phrase that the auditor's consideration of internal control is not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.
- (iii) **To evaluate the appropriateness** of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- (iv) **To conclude on the appropriateness of management's use of the going concern basis** of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. If the auditor concludes that a material uncertainty exists, the auditor is required to draw attention in the auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify the opinion. The auditor's conclusions are based on the audit evidence obtained up to the date of the auditor's report. However, future events or conditions may cause an entity to cease to continue as a going concern.
- (v) When the financial statements are prepared in accordance with a fair presentation framework, **to evaluate the overall presentation, structure and content of the financial statements**, including the

disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- (c) When SA 600, "Using the Work of Another Auditor", applies, further describe the auditor's responsibilities in a group audit engagement by stating, the division of responsibility for the financial information of the entity by indicating the extent to which the financial information of components is audited by the other auditors have been included in the financial information of the entity, e.g., the number of divisions/branches/subsidiaries or other components audited by other auditors

(III) **The Auditor's Responsibilities for the Audit of the Financial Statements section of the auditor's report also shall:**

(a) **State that the auditor communicates with those charged with governance regarding, among other matters:**

-  the planned scope and timing of the audit and
-  significant audit findings,
-  including any significant deficiencies in internal control that the auditor identifies during the audit;

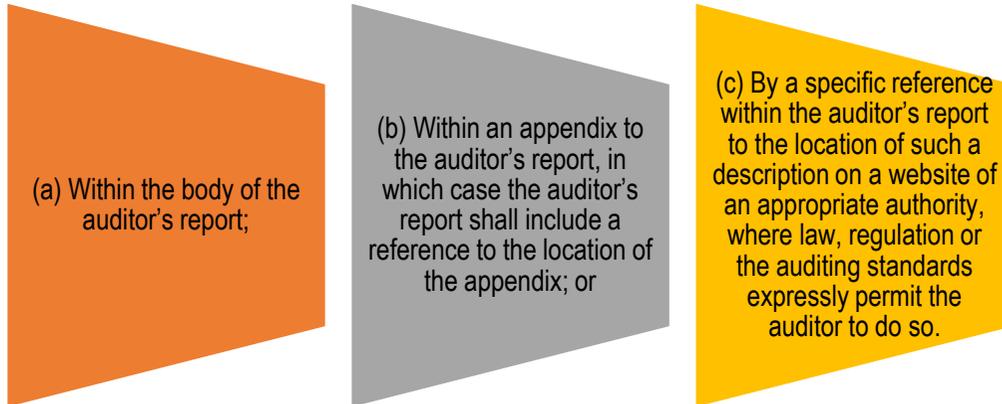
(b) **State that the auditor provides those charged with governance with a statement that the auditor has:**

-  complied with relevant ethical requirements regarding independence and
-  communicate with them all relationships and
-  other matters that may reasonably be thought to bear on the auditor's independence, and where applicable, related safeguards; and

- (c) For audits of financial statements of all such entities **for which key audit matters are communicated in accordance with SA 701**, state that, from the matters communicated with those charged with governance, the auditor determines those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters.

In accordance with the requirements of SA 701, the auditor describes these matters in the auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, the auditor determines that a matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

9. **Location of the description of the auditor's responsibilities for the audit of the financial statements:** The description of the auditor's responsibilities for the audit of the financial statements required by this SA shall be included:



When the auditor refers to a description of the auditor's responsibilities on a website of an appropriate authority, the auditor shall determine that such description addresses, and is not inconsistent with, the requirements of this SA.

10. **Other Reporting Responsibilities:**

- (a) If the auditor addresses other reporting responsibilities in the auditor's report on the financial statements that are in addition to the auditor's responsibilities under the SAs, these other reporting responsibilities shall be addressed in a separate section in the auditor's report with a heading titled "Report on Other Legal and Regulatory Requirements" or otherwise as appropriate to the content of the section, unless these other reporting responsibilities address the same topics as those presented under the reporting responsibilities required by the SAs in which case the other reporting responsibilities may be presented in the same section as the related report elements required by the SAs.
- (b) If other reporting responsibilities are presented in the same section as the related report elements required by the SAs, the auditor's report shall clearly differentiate the other reporting responsibilities from the reporting that is required by the SAs.
- (c) If the auditor's report contains a separate section that addresses other reporting responsibilities, the requirements of this SA shall be included under a section with a heading "Report on the Audit of the Financial Statements." The "Report on Other Legal and Regulatory Requirements" shall follow the "Report on the Audit of the Financial Statements."
11. **Signature of the Auditor:** The auditor's report shall be signed. The report is signed by the auditor (i.e. the engagement partner) in his personal name. Where the firm is appointed as the auditor, the report is signed in the personal name of the auditor and in the name of the

audit firm. The partner/proprietor signing the audit report also needs to mention the membership number assigned by the Institute of Chartered Accountants of India. They also include the registration number of the firm, wherever applicable, as allotted by ICAI, in the audit reports signed by them.

The report is to be signed by the maker of the report. Normally, a chartered accountant in practice signs the report in the name he is registered as a practitioner. If he is an individual, it may be his individual name or the firm name of which he is the sole proprietor. For those members in practise as a partnership firm, it is usual for them to sign in the firm name. Under Section 145 read with Section 141(2) of the Companies Act, 2013, only the person appointed as an auditor of the company or, where a firm is so appointed, only the partner in the firm who is a chartered accountant, may sign the auditor's report or sign or authenticate any other document of the company required by law to be signed or authenticated by the auditor.

It is obvious that the person appointed makes the report; otherwise the very essence of the appointment of a particular man or firm will be lost. In a profession, the particular skill and reputation of the practitioner counts considerably and if anybody else is allowed to make the report on behalf of the person appointed, then this confidence in the person will cease to be a factor. This has other implications also from the point of view of professional responsibility; it will create an unusual legal situation. It also has implications from the standpoint of the practitioner. If in respect of appointments held by him, the reports are made by others, gradually the goodwill of the practitioner will end and the clients may shift to the person actually making the report.

If A, B and C were in practice as ABC & Co. Chartered Accountants, any of A or B or C could sign as "ABC & Co." in his own hand. But now in view of the objection raised by the Department of Company Affairs to this practice, the Council of the Institute in the SA 700 "The Auditor's Report on Financial Statements" has recommended to the members who are in practice in partnership, that signature on or authentication of the auditor's report or any other document required to be signed or authenticated by the auditor should be made in the following manner.



For ABC and Co.  
Chartered Accountants  
Firm Registration Number  
Signature

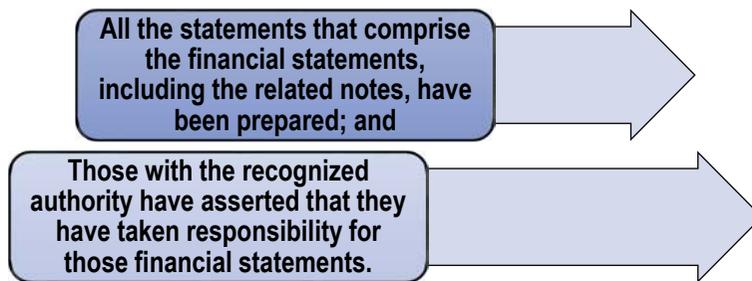
(Name of the Member Signing the Audit Report)

(Designation {Partner/Proprietor})

In addition to the provisions of the Companies Act, 2013 referred to above, Clause (12) of Part I of the First Schedule to the Chartered Accountants Act, 1949 provides that a chartered accountant in practice shall be deemed to be guilty of professional misconduct if

he allows a person, not being a member of the Institute or a member not being his partner, to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements. The provision is intended to safeguard the professional purity by excluding non-chartered accountants from signing the aforesaid documents. By excluding chartered accountants who are not partners, it seeks to keep the line of professional responsibility clear. Partners are mutual agents and therefore, allowing a partner to sign does not interfere with the clarity of responsibility.

12. **Place of Signature:** The auditor's report shall name specific location, which is ordinarily the city where the audit report is signed.
13. **Date of the Auditor's Report:** The auditor's report shall be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements, including evidence that:



### 3.3 Auditor's Report Prescribed by Law or Regulation

If the auditor is required by law or regulation applicable to the entity to use a specific layout, or wording of the auditor's report, the auditor's report shall refer to Standards on Auditing only if the auditor's report includes, at a minimum, each of the following elements:

- (1) A title.
- (2) An addressee, as required by the circumstances of the engagement.
- (3) An Opinion section containing an expression of opinion on the financial statements and a reference to the applicable financial reporting framework used to prepare the financial statements.
- (4) An identification of the entity's financial statements that have been audited.
- (5) A statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit, and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements. The statement shall refer to the Code of Ethics issued by ICAI.

- (6) Where applicable, a section that addresses, and is not inconsistent with, the reporting requirements of SA 570.
- (7) Where applicable, a Basis for Qualified (or Adverse) Opinion section that addresses, and is not inconsistent with, the reporting requirements of SA 570 (Revised).
- (8) Where applicable, a section that includes the information required by SA 701, or additional information about the audit that is prescribed by law or regulation and that addresses, and is not inconsistent with, the reporting requirements in that SA 701.
- (9) A description of management's responsibilities for the preparation of the financial statements and an identification of those responsible for the oversight of the financial reporting process that addresses, and is not inconsistent with, the requirements.
- (10) A reference to Standards on Auditing and the law or regulation, and a description of the auditor's responsibilities for an audit of the financial statements that addresses, and is not inconsistent with, the requirements.
- (11) The auditor's signature.
- (12) The Place of signature
- (13) The date of the auditor's report.

### **3.4 Auditor's Report for Audits Conducted in Accordance with Both Standards on Auditing Issued by ICAI and International Standards on Auditing or Auditing Standards of Any Other Jurisdiction:**

An auditor may be required to conduct an audit in accordance with, in addition to the Standards on Auditing issued by ICAI, the International Standards on Auditing or auditing standards of any other jurisdiction. If this is the case, the auditor's report may refer to Standards on Auditing in addition to the International Standards on Auditing or auditing standards of such other jurisdiction, but the auditor shall do so only if:

- (a) There is no conflict between the requirements in the ISAs or such auditing standards of other jurisdiction and those in SAs that would lead the auditor:
  - (i) to form a different opinion, or
  - (ii) not to include an Emphasis of Matter paragraph or Other Matter paragraph that, in the particular circumstances, is required by SAs; **and**
- (b) The auditor's report includes, at a minimum, each of the elements set out in Auditor's Report Prescribed by Law or Regulation discussed above when the auditor uses the layout or wording specified by the Standards on Auditing. However, reference to "law or regulation" in above paragraph shall be read as reference to the Standards on Auditing. The auditor's report shall thereby identify such Standards on Auditing.

When the auditor's report refers to both the ISAs or the auditing standards of a specific jurisdiction and the Standards on Auditing issued by ICAI, the auditor's report shall clearly identify the same including the jurisdiction of origin of the other auditing standards.

#### Supplementary Information Presented with the Financial Statements:

If supplementary information that is not required by the applicable financial reporting framework is presented with the audited financial statements, the auditor shall evaluate:

whether, in the auditor's professional judgment, supplementary information is nevertheless an integral part of the financial statements due to its nature or how it is presented. When it is an integral part of the financial statements, the supplementary information shall be covered by the auditor's opinion.

whether such supplementary information is presented in a way that sufficiently and clearly differentiates it from the audited financial statements. If this is not the case, then the auditor shall ask management to change how the unaudited supplementary information is presented. If management refuses to do so, the auditor shall identify the unaudited supplementary information and explain in the auditor's report that such supplementary information has not been audited.



## 4. SA 701, "COMMUNICATING KEY AUDIT MATTERS IN THE INDEPENDENT AUDITOR'S REPORT"

This SA 701 provide guidance regarding communication of Key Audit Matters. Key Audit matter are those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.

### 4.1 Purpose

The purpose of communicating key audit matters is to enhance the communicative value of the auditor's report by providing greater transparency about the audit that was performed. Communicating key audit matters provides additional information to intended users of the financial statements ("intended users") to assist them in understanding those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Communicating key audit matters may also assist intended users in understanding the entity and areas of significant management judgment in the audited financial statements.

### 4.2 Scope

Communicating key audit matters in the auditor's report is in the context of the auditor having formed an opinion on the financial statements as a whole. Communicating key audit matters in the auditor's report is not:

- (a) A substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise

<b>necessary to achieve fair presentation;</b>
<b>(b) A substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705 (Revised);</b>
<b>(c) A substitute for reporting in accordance with SA 570 (Revised) when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern; or</b>
<b>(d) A separate opinion on individual matters.</b>

This SA applies to audits of complete sets of general purpose financial statements of listed entities and circumstances when the auditor otherwise decides to communicate key audit matters in the auditor's report.

This SA also applies when the auditor is required by law or regulation to communicate key audit matters in the auditor's report. However, SA 705 (Revised) prohibits the auditor from communicating key audit matters when the auditor disclaims an opinion on the financial statements, unless such reporting is required by law or regulation.

### 4.3 Determining Key Audit Matters

The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:

<b>(a) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315</b>
<b>(b) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.</b>
<b>(c) The effect on the audit of significant events or transactions that occurred during the period.</b>

### 4.4 Communicating Key Audit Matters

The introductory language in this section of the auditor's report shall state that:

- (a) Key audit matters are those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements [of the current period]; and.
- (b) These matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, and the auditor does not provide a separate opinion on these matters.

**Illustration**

The following illustrates the presentation in the auditor's report if the auditor has determined there are no key audit matters to communicate:

**Key Audit Matters**

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



## 5. SA 705, "MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT"

**Modified Opinions:** SA 705 deals with the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with SA 700 (Revised), the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary.

The succinct requirements of this SA 705 are given below-

### 5.1 Types of Modified Opinions:

Types of Modified Opinions as per SA 705:	(i) Qualified Opinion
	(ii) Adverse Opinion
	(iii) Disclaimer of Opinion

The decision regarding which type of modified opinion is appropriate depends upon:

- The nature of the matter giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated; and
- The auditor's judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements.

### 5.2 Objective

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

- (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

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

The auditor shall modify the opinion in the auditor's report when:

The auditor concludes that, based on the audit evidence obtained, 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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### 5.4 Determining the Type of Modification to the Auditor's Opinion:

**5.4.1 Qualified Opinion:** The auditor shall express a qualified opinion when:

- (a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or
- (b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

#### Illustrative Audit Opinion:



“The Company's has been unable to re-negotiate or obtain replacement financing. This situation indicates the existence of a material uncertainty that may cast significant doubt on the Company's ability to continue as a going concern and therefore, the Company may be unable to realize its assets and discharge its liabilities in the normal course of business. The financial statements (and notes thereto) do not fully disclose this fact.” You are required to identify the type of opinion and draft the same.

In view of circumstances mentioned in SA 705, the auditor should give **Qualified Opinion** in above case. Draft qualified opinion is given as under;

#### Qualified Opinion

In our opinion, except for the incomplete disclosure of the information referred to in the Basis for Qualified Opinion paragraph, the financial statements give the information required by the Companies Act, 2013, in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India:

- (a) in the case of the Balance Sheet, of the state of affairs of the company as at March 31, 20X1;

- (b) in the case of the Profit and Loss Account, of the profit/ loss for the year ended on that date; and
- (c) in the case of the cash flow statement, of the cash flows for the year ended on that date.

**5.4.2 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.

### CASE STUDY

“The Company’s financing arrangements expired and the amount outstanding was payable on March 31, 20X0. The Company has been unable to re-negotiate or obtain replacement financing and is considering filing for bankruptcy. These events indicate a material uncertainty that may cast significant doubt on the Company’s ability to continue as a going concern and therefore it may be unable to realize its assets and discharge its liabilities in the normal course of business. The financial statements (and notes thereto) do not disclose this fact.” You are required to identify the type of opinion and draft the same.

In view of circumstances mentioned in SA 705, the auditor should give **Adverse Opinion** in above case. Draft qualified opinion is given as under;

#### **Adverse Opinion**

In our opinion, because of the omission of the information mentioned in the Basis for Adverse Opinion paragraph, the financial statements do not give the information required by the Companies Act, 2013, in the manner so required and also, do not give a true and fair view in conformity with the accounting principles generally accepted in India:

- (a) in the case of the Balance Sheet, of the state of affairs of the company as at March 31, 20X0; and
- (b) in the case of the Profit and Loss Account, of the profit/loss for the year ended on that date; and
- (c) in the case of the cash flow statement, of the cash flows for the year ended on that date.

**5.4.3 Disclaimer of Opinion:** The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive. The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.



### Draft Disclaimer of Opinion

We were engaged to audit the financial statements of ABC & Associates (“the entity”), which comprise the balance sheet as at March 31, 20XX, the statement of Profit and Loss, (the statement of changes in equity)<sup>1</sup> and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

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

## 5.5 Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management-Imposed Limitation after the Auditor Has Accepted the Engagement

If, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor shall request that management remove the limitation.

If management refuses to remove the limitation, the auditor shall communicate the matter to those charged with governance, unless all of those charged with governance are involved in managing the entity, and determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence.

### **If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall determine the implications as follows:**

- (a) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor shall qualify the opinion; or
- (b) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall:
  - (i) Withdraw from the audit, where practicable and possible under applicable law or regulation; or
  - (ii) If withdrawal from the audit before issuing the auditor’s report is not practicable or possible, disclaim an opinion on the financial statements.

<sup>1</sup> Where applicable.

## 5.6 If the auditor decides to withdraw

When the auditor decides to withdraw before withdrawing, the auditor shall communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion.

## 5.7 Other Considerations Relating to an Adverse Opinion or Disclaimer of Opinion

When the auditor considers it necessary to express an adverse opinion or disclaim an opinion on the financial statements as a whole, the auditor's report shall not also include an unmodified opinion with respect to the same financial reporting framework on a single financial statement or one or more specific elements, accounts or items of a financial statement. To include such an unmodified opinion in the same report in these circumstances would contradict the auditor's adverse opinion or disclaimer of opinion on the financial statements as a whole.

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

When the auditor modifies the audit opinion, the auditor shall use the heading "Qualified Opinion," "Adverse Opinion," or "Disclaimer of Opinion," as appropriate, for the Opinion section.

### **What special consideration are required for expressing Qualified Opinion?**

When the auditor expresses a qualified opinion due to a material misstatement in the financial statements, the auditor shall state that, in the auditor's opinion, except for the effects of the matter(s) described in the Basis for Qualified Opinion section:

- (a) When reporting in accordance with a fair presentation framework, the accompanying financial statements present fairly, in all material respects (or give a true and fair view of) [...] in accordance with [the applicable financial reporting framework]; or
- (b) When reporting in accordance with a compliance framework, the accompanying financial statements have been prepared, 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 shall use the corresponding phrase "except for the possible effects of the matter(s) ..." for the modified opinion.

### **What special consideration needed for expressing Adverse Opinion?**

When the auditor expresses an adverse opinion, the auditor shall state that, in the auditor's opinion, because of the significance of the matter(s) described in the Basis for Adverse Opinion section:

- (a) When reporting in accordance with a fair presentation framework, the accompanying financial statements do not present fairly (or give a true and fair view of) [...] in accordance with [the applicable financial reporting framework]; or
- (b) When reporting in accordance with a compliance framework, the accompanying financial statements have not been prepared, in all material respects, in accordance with [the applicable financial reporting framework].

#### **What special consideration is required for expressing Disclaimer of Opinion?**

When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor shall:

- (a) State that the auditor does not express an opinion on the accompanying financial statements;
- (b) State that, because of the significance of the matter(s) described in the Basis for Disclaimer of Opinion section, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements; and
- (c) Amend the statement required in SA 700 (Revised), which indicates that the financial statements have been audited, to state that the auditor was engaged to audit the financial statements.

Unless required by law or regulation, when the auditor disclaims an opinion on the financial statements, the auditor's report shall not include a Key Audit Matters section in accordance with SA 701.

#### **What is the Basis for Modification of Opinion (Qualified/Disclaimer /Adverse)?**

When the auditor modifies (Qualification/ Disclaimer/ Adverse) the opinion as above on the financial statements, the auditor shall, in addition to the specific elements required by SA 700 (Revised):

- (a) Amend the heading "Basis for Opinion" to "Basis for Qualified Opinion," "Basis for Adverse Opinion," or "Basis for Disclaimer of Opinion," as appropriate; and
- (b) Within this section, include a description of the matter giving rise to the modification.

If there is a material misstatement of the financial statements that relates to specific amounts in the financial statements (including quantitative disclosures in the notes to the financial statements), the auditor shall include in the Basis for Opinion section, a description and quantification of the financial effects of the misstatement, unless impracticable. If it is not practicable to quantify the financial effects, the auditor shall so state in this section.

If there is a material misstatement of the financial statements that relates to narrative disclosures, the auditor shall include in the Basis for Opinion section an explanation of how the disclosures are misstated.

If there is a material misstatement of the financial statements that relates to the non-disclosure of information required to be disclosed, the auditor shall:

- (a) Discuss the non-disclosure with those charged with governance;
- (b) Describe in the Basis for Opinion section the nature of the omitted information; and
- (c) Unless prohibited by law or regulation, include the omitted disclosures, provided it is practicable to do so and the auditor has obtained sufficient appropriate audit evidence about the omitted information.

If the modification results from an inability to obtain sufficient appropriate audit evidence, the auditor shall include in the Basis for Opinion section the reasons for that inability.

When the auditor expresses a qualified or adverse opinion, the auditor shall amend the statement about whether the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor's opinion to include the word "qualified" or "adverse", as appropriate.

When the auditor disclaims an opinion on the financial statements, the auditor's report shall not include following elements required under SA 700

- (a) A reference to the section of the auditor's report where the auditor's responsibilities are described; and
- (b) A statement about whether the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

Even if the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements, the auditor shall describe in the Basis for Opinion section the reasons for any other matters of which the auditor is aware that would have required a modification to the opinion, and the effects thereof.

**How Auditor should give description of Auditor's Responsibilities for the Audit of the Financial Statements When the Auditor Disclaims an Opinion on the Financial Statements?**

When the auditor disclaims an opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence, the auditor shall amend the description of the auditor's responsibilities required by SA 700 (Revised) to include only the following:

- (a) A statement that the auditor's responsibility is to conduct an audit of the entity's financial statements in accordance with Standards on Auditing and to issue an auditor's report;

- (b) A statement that, however, because of the matter(s) described in the Basis for Disclaimer of Opinion section, the auditor was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements; and
- (c) The statement about auditor independence and other ethical responsibilities required in SA 700.

## 5.9 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 wording of the modification.

Nature of Matter Giving Rise to the Modification:	Auditor's judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements	
	Material but not pervasive	Material and pervasive
Financial Statements are materially misstated	Qualified Opinion	Adverse Opinion
Inability to obtain Sufficient appropriate audit evidence	Qualified Opinion	Disclaimer of Opinion

## 6 SA 706, "EMPHASIS OF MATTER PARAGRAPHS AND OTHER MATTER PARAGRAPHS IN THE INDEPENDENT AUDITOR'S REPORT"

### 6.1 Objective

The objective of the auditor, having formed an opinion on the financial statements, is to draw users' attention, when in the auditor's judgment it is necessary to do so, by way of clear additional communication in the auditor's report, to:

- (a) A matter, although appropriately presented or disclosed in the financial statements, that is of such importance that it is fundamental to users' understanding of the financial statements; or
- (b) As appropriate, any other matter that is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

**Emphasis of Matter paragraph** – A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's

judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

**Other Matter paragraph** – A paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

## 6.2 When to give emphasis of Matter Paragraphs in the Auditor's Report?

If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided:

- (a) The auditor would not be required to modify the opinion in accordance with SA 705 (Revised) as a result of the matter; and
- (b) When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report.



### These circumstances may include:

- When a financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation.
- To alert users that the financial statements are prepared in accordance with a special purpose framework.
- When facts become known to the auditor after the date of the auditor's report and the auditor provides a new or amended auditor's report (i.e., subsequent events).

## 6.3 When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall:

- (a) Include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term "Emphasis of Matter";
- (b) Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements. The paragraph shall refer only to information presented or disclosed in the financial statements; and
- (c) Indicate that the auditor's opinion is not modified in respect of the matter emphasized.

### When to issue other Matter Paragraphs in the Auditor's Report?

If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report, the auditor shall include an Other Matter paragraph in the auditor's report, provided:

- (a) This is not prohibited by law or regulation; and
- (b) When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report.

When the auditor includes an Other Matter paragraph in the auditor's report, the auditor shall include the paragraph within a separate section with the heading "Other Matter," or other appropriate heading.



**Circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are:**

- An uncertainty relating to the future outcome of exceptional litigation or regulatory action.
- A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report.
- Early application (where permitted) of a new accounting standard that has a material effect on the financial statements.
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

### Is there any duty to communicate with Those Charged with Governance?

If the auditor expects to include an Emphasis of Matter or an Other Matter paragraph in the auditor's report, the auditor shall communicate with those charged with governance regarding this expectation and the wording of this paragraph.

**Note:** Students are advised to refer Illustration of Emphasis of Matter Para is given in appendix at the end of the Chapter.



## 7. DISTINCTION BETWEEN NOTES ON ACCOUNTS AND QUALIFICATIONS

As a general practice, the management would normally prefer to explain their view point and assessment on all matters involving difference of opinion between them and the auditors by way of notes in the financial statements, for better understanding of the facts of the matters by users of financial statements. Such notes represents management's stand on the matter while the auditor records his disagreement on the matters by way of qualifications in the auditor's report.

Students should note that client and auditor are two separate independent parties and in real life situations, at times, the client management may insist upon the auditor for not modifying his audit opinion considering the management has disclosed full facts and assessment of the matter through notes on the financial statements. However, the auditor needs to exercise his professional judgement and assess if the disclosure alone would suffice or in case, he also needs to modify his audit report by either inserting a qualification or Emphasis of matter.

Once auditor concludes that modification of his report in relation to the specific matter under question, is warranted, he may choose to refer to the specific note given by the management and thereafter, continue explaining more facts and his assessment on the matter including quantification and impact on the various financial statements captions, to the extent possible.

The Auditor must express the nature of qualification, in a clear and unambiguous manner. Where the Auditor answers any of the statutory affirmations in the negative or with a qualification, his report shall state the reasons for such answer. All qualifications should be contained in the Auditor's Report.

Where the company has committed an irregularity resulting in a breach of law, the Auditor should bring the same to the notice of the shareholders by properly qualifying his report. A qualified opinion should be expressed as "except for" for the effects of the matter to which qualification related. It would not be appropriate to use phrases such as "with the foregoing explanation" or "subject to" in the opinion paragraph as these are not sufficiently clear or forceful.

Notes – Report Relationship – Where notes of a qualificatory nature appear in the accounts, the Auditors should state all qualifications independently in their report so that the user can assess the significance of these qualifications. A reference to the notes to Accounts in the Auditors' Report does not automatically become a qualification.

**Note : Students are advised to refer examples/illustrative formats given at the end of the Chapter for better understanding of the differences.**

## 8. DISTINCTION BETWEEN AUDIT REPORT AND CERTIFICATE

The term 'report' is used where an expression of opinion is involved. The term 'certificate' is preferable where the auditor comments on or verifies facts such as a verification of investment by inspection or the checking of ballot papers on a poll in a company meeting. Under the Companies Act, 2013, a number of situations are there where an auditor is required to issue a certificate rather than a report, like under Section 66 of the Companies Act, 2013, an auditor is required to file a certificate in the tribunal where company is proposing for the reduction of capital. However, the report under Section 143 of the Companies Act, 2013, is an opinion based report and is not a certificate.

**Some situations where Audit Reports and Certificates are required is given below -**

- (1) Under the Payment of Bonus Act, 1965, a chartered accountant may be required to issue a 'report' on the computation of bonus payable. The report may be as under:

"We have reviewed the figures in the above computation in comparison with the books and records produced to us, the audit of which has already been completed by us and report that subject to the notes given on face of the computation in our opinion, and to the best of our knowledge and belief and according to the information and explanation given to us, the above computation is in due accordance therewith and has been made on a basis reasonably consistent with the provisions of the Payment of Bonus Act, 1965."

Place: For X & Co.

Date: Chartered Accountants

- (2) **Auditor's Report in accordance with Regulation 54 of the SEBI (Mutual Fund) Regulations, 1993.**

- (i) All Mutual funds shall be required to get their accounts audited in terms of a provision to that effect in their trust deeds. The Auditor's Report shall form a part of the Annual Report. It should accompany the Abridged Balance Sheet and Revenue Account. The auditor shall report to the Board of Trustees and not to the unit holders.
- (ii) The auditor shall state whether:
1. He has obtained all information and explanations which, to the best of his knowledge and belief, were necessary for the purpose of his audit.
  2. The Balance Sheet and the Revenue Account are in agreement with the books of account of the fund.
- (iii) The auditor shall give his opinion as to whether:
1. The Balance Sheet gives a true and fair view of the scheme wise state of affairs' of the fund as at the balance sheet date, and
  2. The Revenue Account gives a true and fair view of the scheme wise surplus/deficit of the fund for the year/period ended at the balance sheet date.

## 9. COMMUNICATION TO MANAGEMENT AND THOSE CHARGED WITH GOVERNANCE

As per SA 260 Communication with Those Charged with Governance, it is auditor's responsibility to communicate with those charged with governance in an audit of financial statements irrespective of an entity's governance structure or size, particular considerations apply where all of those charged with governance are involved in managing an entity, and for listed entities.

<b>The objectives of the auditor are</b>	
	To communicate clearly with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, and an overview of the planned scope and timing of the audit;
	To obtain from those charged with governance information relevant to the audit;
	To provide those charged with governance with timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process; and
	To promote effective two-way communication between the auditor and those charged with governance.

The auditor shall determine the appropriate person(s) within the entity's governance structure with whom to communicate. If the auditor communicates with a subgroup of those charged with governance, for example, an audit committee, or an individual, the auditor shall determine whether the auditor also needs to communicate with the governing body.

### **9.1 When All of Those Charged with Governance Are Involved in Managing the Entity**

In some cases, all of those charged with governance are involved in managing the entity, for example, a small business where a single owner manages the entity and no one else has a governance role. In these cases, if matters required by this SA are communicated with person(s) with management responsibilities, and those person(s) also have governance responsibilities, the matters need not be communicated again with those same person(s) in their governance role. These matters are noted in paragraph 16(c). The auditor shall nonetheless be satisfied that communication with person(s) with management responsibilities adequately informs all of those with whom the auditor would otherwise communicate in their governance capacity. (Ref: Para. A8)

### **9.2 Matters to Be Communicated**

The auditor shall communicate with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, including that:

- (a) The auditor is responsible for forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance; and
- (b) The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

### **9.3 Planned Scope and Timing of the Audit**

The auditor shall communicate with those charged with governance an overview of the planned scope and timing of the audit, which includes communicating about the significant risks identified by the auditor.

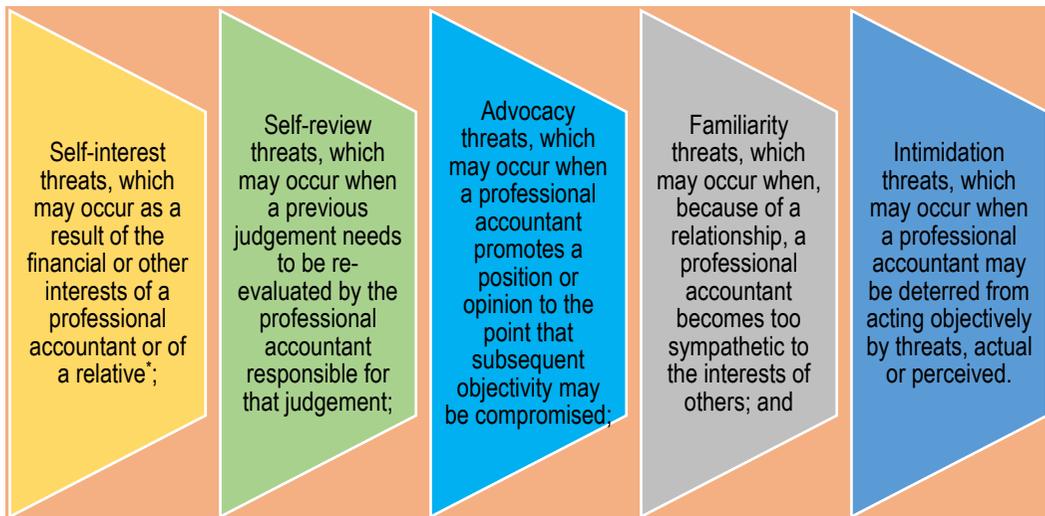
## 9.4 Significant Findings from the Audit

The auditor shall communicate with those charged with governance:

(a)	The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures. When applicable, the auditor shall explain to those charged with governance why the auditor considers a significant accounting practice, that is acceptable under the applicable financial reporting framework, not to be most appropriate to the particular circumstances of the entity;
(b)	Significant difficulties, if any, encountered during the audit;
(c)	Unless all of those charged with governance are involved in managing the entity: <ol style="list-style-type: none"> <li>i. Significant matters arising during the audit that were discussed, or subject to correspondence, with management; and</li> <li>ii. Written representations the auditor is requesting;</li> </ol>
(d)	Circumstances that affect the form and content of the auditor's report, if any; and
(e)	Any other significant matters arising during the audit that, in the auditor's professional judgment, are relevant to the oversight of the financial reporting process.

## 10. SELF REVIEW THREATS

Compliance with the fundamental principles may potentially be threatened by a broad range of circumstances. Many threats fall into the following categories:



The nature and significance of the threats may differ depending on whether they arise in relation to the provision of services to a **financial statement audit client\***, a non- financial statement audit **assurance client\*** or a non-assurance client.

### 10.1 Meaning- Self Review Threats

*Self-review threats*, which occur when during a review of any judgement or conclusion reached in a previous audit or non-audit engagement, or when a member of the audit team was previously a director or senior employee of the client. Instances where such threats come into play are

- (i) when an auditor having recently been a director or senior officer of the company, and
- (ii) when auditors perform services that are themselves subject matters of audit.



**Circumstances that may create self-review threats include, but are not limited to:**

 The discovery of a significant error during a re-evaluation of the work of the professional accountant in public practice.



Reporting on the operation of financial systems after being involved in their design or implementation.



Having prepared the original data used to generate records that are the subject matter of the engagement.



A member of the **assurance team\*** being, or having recently been, a **director or officer\*** of that client.



A member of the assurance team being, or having recently been, employed by the client in a position to exert direct and significant influence over the subject matter of the engagement.



Performing a service for a client that directly affects the subject matter of the assurance engagement.

### 10.2 Safeguards that may eliminate or reduce such threats to an acceptable level fall into two broad categories:



## 11. REPORTING REQUIREMENTS IN CASE OF COMPARATIVE INFORMATION

SA 710 Comparative Information-Corresponding Figures and Comparative Financial Statements deals with auditor's responsibility regarding comparative information in an audit of financial

statement. There are two different broad approaches to the auditor's responsibilities in respect of comparative information: Corresponding figures and Comparative financial statement.

The essential audit reporting differences between the approaches are:

- (a) For corresponding figures, the auditor's opinion on the financial statements refers to the current period only; whereas
- (b) For comparative financial statements, the auditor's opinion refers to each period for which financial statements are presented.

The objectives of the auditor are to obtain sufficient appropriate audit evidence about whether the comparative information included in the financial statements has been presented, in all material respects, in accordance with the requirements for comparative information in the applicable financial reporting framework; and to report in accordance with the auditor's reporting responsibilities.

### 11.1 Audit Procedures for Comparative Information:

- (a) **Perform Specific audit Procedure:** For determining that the financial statement contains appropriately classified comparative information, the auditor should:
  - Ensure that comparative information agrees with the amount and other disclosure presented in the prior period.
  - The accounting policies applied are consistent with those applied in current period.
  - If there have been any changes in the application of accounting policies than they are properly disclosed and presented.
- (b) **Evaluating the impact on financial statement:** If the auditor becomes aware of any possible misstatement in the comparative information, then:
  - He should perform the necessary audit procedures to obtain sufficient audit evidence.
  - If the auditor had audited the prior period's financial statement than he should follow the relevant requirements of SA 560.
- (c) **Written Representation:** As required by SA 580, the auditor should also request written representation. He should also obtain a specific written representation regarding any prior period item that is disclosed in current year's financial statement.

### 11.2 Audit Reporting:

- (a) **With Reference to Corresponding Figures:** When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures except in the following circumstances:

- If the auditor's report of the previous period contains other than an unqualified opinion.
- If the auditor is of the opinion, and he has sufficient evidence in this regard, that a material misstatement exists in the financial statement of prior period, which was not addressed earlier.

If the prior period financial statement are not audited, than he should obtain sufficient audit evidence that the opening balance does not contain any material misstatement.

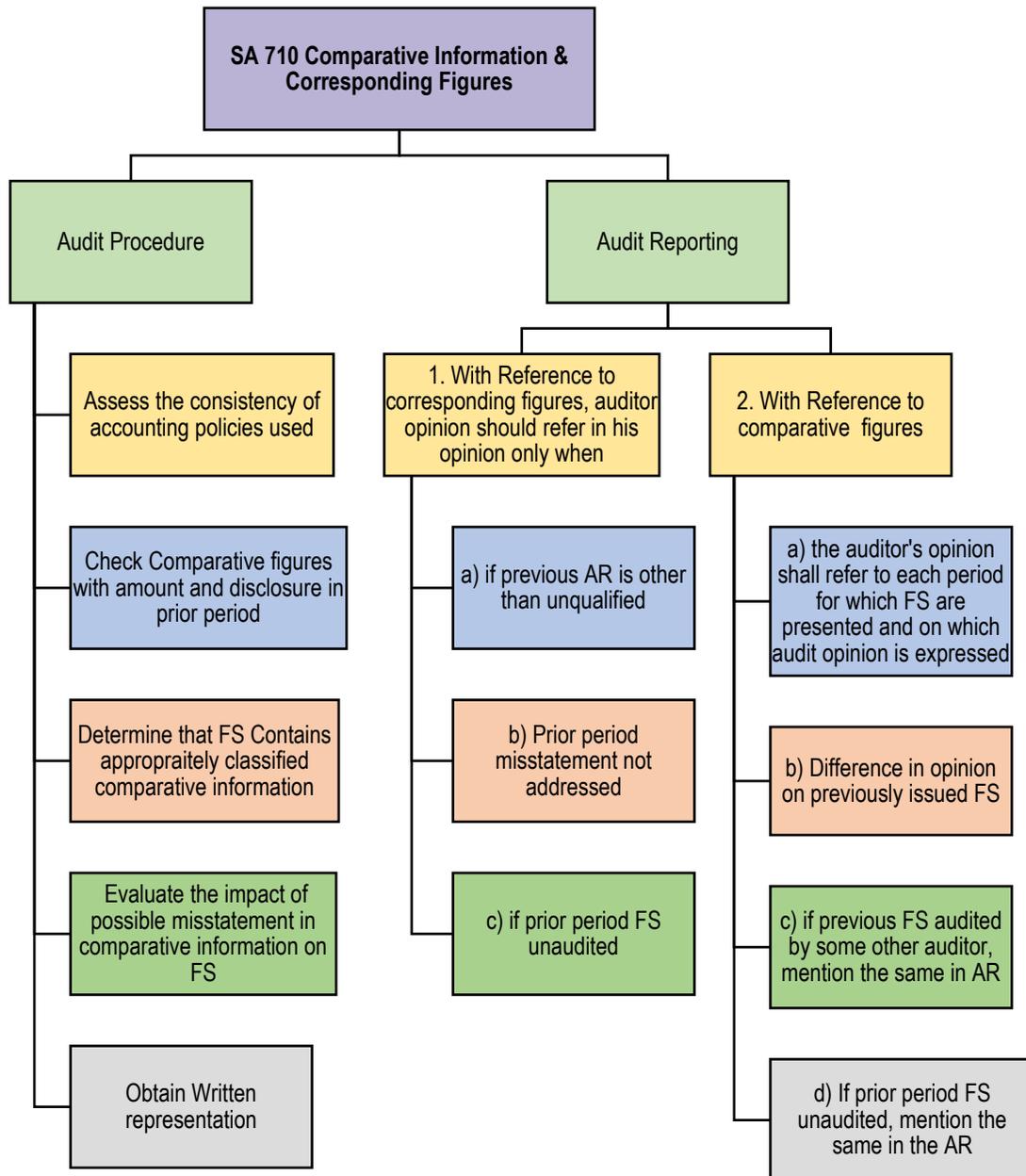
(b) **With Reference to Comparative Financial Statement:** When comparative financial statement are presented -

- The auditor's opinion shall refer to each period for which the financial statements are presented.
- When reporting on current period's audit, if the auditor's opinion on such prior period financial statement differs from the opinion previously issued on such financial statement, the auditor shall disclose the substantive reason for the different opinion in other matter paragraph in his report.
- If the auditor concludes that a material misstatement is present in the previously audited figures of financial statement, he should report it to the appropriate level of the management and request that the predecessor auditor be informed. If then the prior years statements are amended with new report by the predecessor auditor, then the auditor shall report only on the current period.

(c) **Reporting treatment common to both (for corresponding figures and comparative information):**

- (i) If the financial statement of the prior period were audited by a predecessor auditor, the auditor (is permitted by law or regulation to refer to the predecessor audit report – on case of corresponding figures and decides to do so) shall state in his audit report:
  - That the financial statement of the prior period were audited by a predecessor auditor;
  - The type of the opinion expressed by the predecessor auditor;
  - The date of that audit report.
- (ii) If the prior period financial statement were not audited than he shall report the same in other matter paragraph in his audit report that the corresponding/comparative figures are unaudited. However, the disclosure does not relieve him from his responsibility of obtaining sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements.

**(Note: Students are advised to refer Series of SA 700 on Audit Reporting and Conclusion for better understanding)**





## 12. ILLUSTRATIVE AUDIT REPORTS

### Example 1- Illustration of Emphasis of Matter Para

#### INDEPENDENT AUDITOR'S REPORT

##### To the Members of ABC Company Limited

Report on the Audit of the Standalone Financial Statements

##### Opinion

We have audited the standalone financial statements of ABC Company Limited ("the Company"), which comprise the balance sheet as at March 31, 20X1, and the statement of Profit & Loss, (statement of changes in equity) and the statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information (in which are included the Returns for the year ended on that date audited by the branch auditors of the Company's branches located at *(location of branches)*)<sup>13</sup>.

In our opinion, and to the best of our information and according to the explanations given to us the aforesaid financial statements, *give a true and fair view*, in conformity with the accounting principles generally accepted in India, of the state of affairs of the Company as at March 31<sup>st</sup>, 2XXX and profit/loss, *(changes in equity)* and its cash flows for the year ended on that date.

##### Basis for Opinion

We conducted our audit in accordance with Standards on Auditing (SAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements as per the *ICAI's Code of Ethics and the provisions of the Companies Act, 2013*, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

##### Emphasis of Matter

We draw attention to Note X of the financial statements, which describes the effects of a fire in the Company's production facilities. Our opinion is not modified in respect of this matter.

##### Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

[Description of each key audit matter in accordance with SA 701.]

**Other Matter**

The financial statements of ABC Company for the year ended March 31, 20X0, were audited by another auditor who expressed an unmodified opinion on those statements on March 31, 20X1.

**Responsibilities of Management and Those Charged with Governance for the Financial Statements**

*[Reporting in accordance with SA 700 (Revised) – see Illustration 1 in SA 700 (Revised) given in Auditing Pronouncement.]*

Auditor's Responsibilities for the Audit of the Financial Statements

*[Reporting in accordance with SA 700 (Revised) – see Illustration 1 in SA 700 (Revised).]*

**Report on Other Legal and Regulatory Requirements**

*[Reporting in accordance with SA 700 (Revised) – see Illustration 1 in SA 700 (Revised).]*

For XYZ & Co  
Chartered Accountants  
(Firm's Registration No.)

Signature

(Name of the Member Signing the Audit Report)

(Designation)

**Example 2- Illustration of Emphasis of Matter in a situation when the business of one of the Indian branch office of an existing foreign company- ABC Limited is being transferred by way of slump sale to another newly incorporated subsidiary company in India- XYZ Private Limited**

**Relevant Note given by the management in the financial statements of India Branch Office of ABC Limited**

"During the year, ABC Limited ('the Company') has incorporated a private limited company ('XYZ Private Limited') in India for the purpose of furtherance of the Company's objectives and has entered into a Business Transfer Agreement dated October 5, 2016 with XYZ Private Limited for transfer of all assets and liabilities alongwith the business of India Branch Office to XYZ Private Limited on going concern basis effective April 01, 2016. Further, the Reserve Bank of India (RBI) vide letter No. .... dated December 22, 2016 has also granted approval for transfer of assets and liabilities and business of India Branch Office to XYZ Private Limited.

ABC Limited has confirmed that it shall provide continuing financial and operational support to its Branch Office in India for its operations during the transitional period and loss incurred post the date of transfer of business to XYZ Private Limited, if any, shall be borne by ABC Limited

The current year financial statements of India Branch Office have been prepared on the basis that the Branch Office does not continue to be a going concern and all its assets are carried in the books of accounts at the values likely to be recovered at the time of closure of operations, to the extent ascertainable at the time of preparation of these financial statements".

### **INDEPENDENT AUDITOR'S REPORT**

#### **To the Members of India Branch Office of ABC Limited**

Report on the Audit of the Standalone Financial Statements

#### **Opinion**

We have audited the standalone financial statements of India Branch Office of ABC Limited ("the Company"), which comprise the balance sheet as at March 31, 20X1, and the statement of Profit & Loss, (statement of changes in equity) and the statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information.

In our opinion, and to the best of our information and according to the explanations given to us the aforesaid financial statements, *give a true and fair view*, in conformity with the accounting principles generally accepted in India, of the state of affairs of the India Branch Office of the Company as at March 31<sup>st</sup>, 2XXX and profit/loss, (*changes in equity*) and its cash flows for the year ended on that date.

#### **Basis for Opinion**

We conducted our audit in accordance with Standards on Auditing (SAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements as per the *ICAI's Code of Ethics and the provisions of the Companies Act, 2013*, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### **Emphasis of Matter**

We draw attention to Note XX regarding India Branch Office management's intention to close the operations of the Branch Office subject to regulatory approvals. Accordingly, the financial statements have been prepared on the basis that the India Branch Office does not continue to be a going concern and provisions have been made in the books of account for the losses arising or likely to arise on account of closure of operations including the losses on the realizability of current assets.

Our opinion is not modified in respect of this matter.

**Example 3- Qualified Opinion****Relevant Notes given by the management in the financial statements of ABC Limited**

- (a) During the year, the management circulated request for confirmation to key vendors of maintenance expenses and has written-back the liabilities recorded in earlier years of ₹ 2 crores that have not been claimed by these vendors and have also not been responded to management's request for confirmation. The management is confident that the balances are no longer payable and that no further adjustments are required to the financial statements in this regard.
- (b) During the year, the management has undertaken detailed assessment regarding advances of ₹\_\_\_\_ paid to certain project managers including ₹\_\_\_\_ paid during earlier years. The Company has incurred expenses on account of travel expense at various sites in cash and has closing balance of ₹1.75 crores against which management has obtained confirmation from respective project managers for balances aggregating ₹ 0.65 crores and has provided balance amount of ₹1.1 crores as provision for doubtful advances. The management is confident that the expenditure incurred is towards business operations of the Company and that no further adjustments are required to the financial statements in this regard.

**Report on the Audit of the Standalone Financial Statements****Qualified Opinion**

We have audited the standalone financial statements of ABC Limited ("the Company"), which comprise the balance sheet as at March 31, 20X1, and the statement of Profit & Loss, (statement of changes in equity) and the statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information.

In our opinion, and to the best of our information and according to the explanations given to us the aforesaid financial statements, *subject to the matters discussed in Basis for Qualified Opinion paragraph below, the consequential impact, if any, whereof is not quantifiable, give a true and fair view*, in conformity with the accounting principles generally accepted in India, of the state of affairs of the Company as at March 31<sup>st</sup>, 2XXX and profit/loss, (*changes in equity*) and its cash flows for the year ended on that date.

**Basis for Qualified Opinion**

- (a) As stated in Note XX of the financial statements, the management has during the year circulated request for confirmation to key vendors of maintenance expenses and written-back the liabilities recorded in earlier years of ₹ 2 crores considering that these balances have not been claimed by these vendors and they have also not responded to management request for confirmation. In the absence of balance confirmation of these vendors, we are unable to comment upon such write back of ₹2 crores and any further adjustments that may be required to the financial statement in this regard.

- (b) Attention is invited to Note\_\_\_\_ which explains management assessment regarding advances of ₹\_\_\_\_ paid to certain project managers including ₹\_\_\_\_ paid during earlier years. The Company has incurred expenses on account of travel at various sites in cash and has closing balance of ₹1,75 crores against which management has obtained confirmation from respective project managers for balances aggregating ₹ 0.65 crores and has provided balance amount of ₹1.1 crores as provision for doubtful advances. Further, for such transactions, the Company has not complied with provision for deduction of taxes at source.

We strongly recommend that management should undertake these transactions through banking channels and in the absence of any confirmations, we are unable to confirm the completeness of expenses as at year- end and consequential adjustment required to closing tax liabilities and interest thereupon, if any.

We conducted our audit in accordance with Standards on Auditing (SAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements as per the *ICAI's Code of Ethics and the provisions of the Companies Act, 2013*, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion, except for the matters, discussed above.

**Note: Students are advised to refer Illustrations of Independent Auditor's Reports on Financial Statements given in SA 700.**

Illustration 1: An auditor's report on financial statements of a listed entity prepared in accordance with a fair presentation framework

Illustration 2: An auditor's report on consolidated financial statements of a listed company prepared in accordance with a fair presentation framework

Illustration 3 – Auditor's Report on Financial Statements of an Unlisted Company Prepared in Accordance with a Fair Presentation Framework

Illustration 4 – Auditor's Report on Financial Statements of a Non Corporate Entity Prepared in Accordance with a Fair Presentation Framework

**Illustration – Auditor's Report on Financial Statements of Non Corporate Entity Prepared in Accordance with a General Purpose Compliance Framework**

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of an entity, other than a listed company under the Companies Act 2013, required by law or regulation. The audit is not a group audit (i.e., SA 600 does not apply).

- The financial statements are prepared by management of the entity in accordance with the Financial Reporting Framework (XYZ Laws) of Jurisdiction X (that is, a financial reporting framework, encompassing law or regulation, designed to meet the common financial information needs of a wide range of users, but which is not a fair presentation framework).
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in SA 210.
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit are those of the jurisdiction.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with SA 570 (Revised).
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with SA 701.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- The auditor has no other reporting responsibilities required under local law.

**Opinion**

We have audited the financial statements of ABC & Associates (the entity), which comprise the balance sheet as at March 31, 20X1, and the Profit and Loss Account (and the cash flow statement)<sup>2</sup> for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements of the entity are prepared, in all material respects, in accordance with XYZ Laws.

**Basis for Opinion**

We conducted our audit in accordance with Standards on Auditing (SAs). Our responsibilities under those Standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the entity in accordance with the ethical requirements that are relevant to our audit of the financial statements, and we have fulfilled our other responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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<sup>2</sup> Where applicable.

**Responsibilities of Management and Those Charged with Governance for the Financial Statements<sup>3</sup>**

Management is responsible for the preparation of the financial statements in accordance with XYZ Law and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the entity's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the entity's financial reporting process.

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

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with SAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Paragraph 40(b) of this SA explains that the shaded material below can be located in an Appendix to the auditor's report. Paragraph 40(c) explains that when law, regulation or national auditing standards expressly permit, reference can be made to a website of an appropriate authority that contains the description of the auditor's responsibilities, rather than including this material in the auditor's report, provided that the description on the website addresses, and is not inconsistent with, the description of the auditor's responsibilities below.

As part of an audit in accordance with SAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit

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<sup>3</sup> Or other terms that are appropriate in the context of the legal framework of the particular entity.

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>4</sup>

Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the entity to cease to continue as a going concern.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

#### **Illustration – Qualified Opinion due to a Material Misstatement of the Financial Statements**

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of a listed company (registered under the Companies Act, 2013) using a fair presentation framework.
- The financial statements are prepared by management of the entity in accordance with the Accounting Standards prescribed under section 133 of the Companies Act, 2013 (a general purpose framework).
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in SA 210.<sup>5</sup>
- Inventories are misstated. The misstatement is deemed to be material but not pervasive to the financial statements (i.e., a qualified opinion is appropriate).
- The relevant ethical requirements that apply to the audit are the ICAI's Code of Ethics and the provisions of the Companies Act, 2013.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with SA 570 (Revised).

<sup>4</sup> This sentence would be modified, as appropriate, in circumstances when the auditor also has responsibility to issue an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements.

<sup>5</sup> SA 210, *Agreeing the Terms of Audit Engagements*

- Key audit matters have been communicated in accordance with SA 701.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under the Companies Act, 2013.

## Report on the Audit of the Standalone Financial Statements<sup>6</sup>

### Qualified Opinion

We have audited the standalone financial statements of ABC Company Limited (“the Company”), which comprise the balance sheet as at March 31, 20XX, and the statement of Profit and Loss, (*statement of changes in equity*)<sup>7</sup> and the statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information (in which are included the Returns for the year ended on that date audited by the branch auditors of the Company’s branches located at (*location of branches*))<sup>8</sup>.

In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in the *Basis for Qualified Opinion* section of our report, the aforesaid financial statements give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of the Company as at March 31<sup>st</sup>, 2XXX and profit/loss, (*changes in equity*) and its cash flows for the year ended on that date.

### Basis for Qualified Opinion

The Company’s inventories are carried in the Balance Sheet at ₹ XXX. Management has not stated the inventories at the lower of cost and net realizable value but has stated them solely at cost, which constitutes a departure from the Accounting Standards prescribed under section 133 of the Companies Act, 2013. The Company’s records indicate that, had management stated the inventories at the lower of cost and net realizable value, an amount of ₹ xxx would have been required to write the inventories down to their net realizable value. Accordingly, cost of sales would have been increased by ₹ xxx, and income tax, net income and shareholders’ funds would have been reduced by ₹ xxx, ₹ xxx and ₹ xxx, respectively.

We conducted our audit in accordance with Standards on Auditing (SAs) specified under section 143(10) of the Companies Act, 2013. Our responsibilities under those Standards are further described in the *Auditor’s Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the Code of Ethics issued by the Institute of Chartered Accountants of India together with the ethical requirements that are relevant

<sup>6</sup> The sub-title “Report on the Audit of the Standalone Financial Statements” is unnecessary in circumstances when the second sub-title “Report on Other Legal and Regulatory Requirements” is not applicable.

<sup>7</sup> As may be applicable.

<sup>8</sup> As may be applicable.

to our audit of the financial statements under the provisions of the Companies Act, 2013 and we have fulfilled our other ethical responsibilities in accordance with these requirements and the ICAI's Code of Ethics. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

**Note : Students are advised to refer Illustrations of Auditor's Reports with Modifications to the Opinion given in SA 705.**

- Illustration 2: An auditor's report containing an adverse opinion due to a material misstatement of the consolidated financial statements.
- Illustration 3: An auditor's report containing a qualified opinion due to the auditor's inability to obtain sufficient appropriate audit evidence regarding a foreign associate.
- Illustration 4: An auditor's report containing a disclaimer of opinion due to the auditor's inability to obtain sufficient appropriate audit evidence about a single element of the consolidated financial statements.

**Illustration – Disclaimer of Opinion due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence about Multiple Elements of the Financial Statements**

*For purposes of this illustrative auditor's report, the following circumstances are assumed:*

- *Audit of a complete set of financial statements of an entity other than a company incorporated under the Companies Act, 2013, using a fair presentation framework. The audit is not a group audit (i.e., SA 600, does not apply).*
- *The financial statements are prepared by management of the entity in accordance with the Accounting Standards issued by the Institute of Chartered Accountants of India (a general purpose framework).*
- *The terms of the audit engagement reflect the description of management's responsibility for the financial statements in SA 210.*
- *The auditor was unable to obtain sufficient appropriate audit evidence about multiple elements of the financial statements, that is, the auditor was also unable to obtain audit evidence about the entity's inventories and accounts receivable. The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements.*
- *The relevant ethical requirements that apply to the audit are ICAI's Code of Ethics and applicable law/regulation*
- *Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.*
- *A more limited description of the auditor's responsibilities section is required.*
- *In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under relevant law/ regulation.*

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

### Disclaimer of Opinion

We were engaged to audit the financial statements of ABC & Associates (“the entity”), which comprise the balance sheet as at March 31, 20XX, the statement of Profit and Loss, (*the statement of changes in equity*)<sup>10</sup> and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

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

### Basis for Disclaimer of Opinion

We were not appointed as auditors of the Company until after March 31, 20X1 and thus did not observe the counting of physical inventories at the beginning and end of the year. We were unable to satisfy ourselves by alternative means concerning the inventory quantities held at March 31, 20X0 and 20X1, which are stated in the Balance Sheets at ` xxx and ` xxx, respectively. In addition, the introduction of a new computerized accounts receivable system in September 20X1 resulted in numerous errors in accounts receivable. As of the date of our report, management was still in the process of rectifying the system deficiencies and correcting the errors. We were unable to confirm or verify by alternative means accounts receivable included in the Balance Sheet at a total amount of ` xxx as at March 31, 20X1. As a result of these matters, we were unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded inventories and accounts receivable, and the elements making up the statement of Profit and Loss (*and statement of cash flows*)<sup>11</sup>.

### Auditor’s Responsibilities for the Audit of the Financial Statements

Our responsibility is to conduct an audit of the entity’s financial statements in accordance with Standards on Auditing and to issue an auditor’s report. However, because of the matters described in the *Basis for Disclaimer of Opinion* section of our report, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

We are independent of the entity in accordance with the ethical requirements in accordance with the requirements of the Code of Ethics issued by ICAI and the ethical requirements as prescribed under the laws and regulations applicable to the entity.

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

<sup>10</sup> Where applicable.

<sup>11</sup> Where applicable.

### **Illustration of an Auditor's Report that Includes a Key Audit Matters Section, an Emphasis of Matter Paragraph, and an Other Matter Paragraph**

*For purposes of this illustrative auditor's report, the following circumstances are assumed:*

- *Audit of a complete set of financial statements of a listed company (registered under the companies Act, 2013) using a fair presentation framework.*
- *The financial statements are prepared by management of the entity in accordance with the Accounting Standards prescribed under section 133 of the Companies Act, 2013 (a general purpose framework).*
- *The terms of the audit engagement reflect the description of management's responsibility for the financial statements in SA 210.*
- *The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.*
- *The relevant ethical requirements that apply to the audit are those of the ICAI's Code of Ethics and the provisions of the Companies Act, 2013.*
- *Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with SA 570 (Revised).*
- *Between the date of the financial statements and the date of the auditor's report, there was a fire in the entity's production facilities, which was disclosed by the entity as a subsequent event. In the auditor's judgment, the matter is of such importance that it is fundamental to users' understanding of the financial statements. The matter did not require significant auditor attention in the audit of the financial statements in the current period.*
- *Key audit matters have been communicated in accordance with SA 701.*
- *Corresponding figures are presented, and the prior period's financial statements were audited by a predecessor auditor. The auditor is not prohibited by law or regulation from referring to the predecessor auditor's report on the corresponding figures and has decided to do so.*
- *Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.*
- *In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under the Companies Act, 2013.*

## Report on the Audit of the Standalone Financial Statements<sup>12</sup>

### Opinion

We have audited the standalone financial statements of ABC Company Limited (“the Company”), which comprise the balance sheet as at March 31, 20X1, and the statement of Profit & Loss, (statement of changes in equity) and the statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information (in which are included the Returns for the year ended on that date audited by the branch auditors of the Company’s branches located at *(location of branches)*)<sup>13</sup>.

In our opinion, and to the best of our information and according to the explanations given to us the aforesaid financial statements, *give a true and fair view*, in conformity with the accounting principles generally accepted in India, of the state of affairs of the Company as at March 31<sup>st</sup>, 2XXX and profit/loss, *(changes in equity)* and its cash flows for the year ended on that date.

### Basis for Opinion

We conducted our audit in accordance with Standards on Auditing (SAs). Our responsibilities under those standards are further described in the *Auditor’s Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements as per the *ICAI’s Code of Ethics and the provisions of the Companies Act, 2013*, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### Emphasis of Matter<sup>14</sup>

We draw attention to Note X of the financial statements, which describes the effects of a fire in the Company’s production facilities. Our opinion is not modified in respect of this matter.

### Illustration of an Auditor’s Report Containing a Qualified Opinion Due to a Departure from the Applicable Financial Reporting Framework and that Includes an Emphasis of Matter Paragraph

*For purposes of this illustrative auditor’s report, the following circumstances are assumed:*

- *Audit of a complete set of financial statements of an company other than a listed company (registered under the Companies Act, 2013) using a fair presentation framework..*
- *The financial statements are prepared by management of the entity in accordance with the Accounting Standards prescribed under section 133 of the Companies Act, 2013 (a general purpose framework).*

<sup>12</sup> <sup>1</sup> The sub-title “Report on the Audit of the Standalone Financial Statements” is unnecessary in circumstances when the second sub-title “Report on Other Legal and Regulatory Requirements” is not applicable.

<sup>13</sup> As may be applicable

<sup>14</sup> As noted in paragraph A16, an Emphasis of Matter paragraph may be presented either directly before or after the Key Audit Matters section based on the auditor’s judgment as to the relative significance of the information included in the Emphasis of Matter paragraph.

- *The terms of the audit engagement reflect the description of management's responsibility for the financial statements in SA 210.*
- *A departure from the applicable financial reporting framework resulted in a qualified opinion.*
- *The relevant ethical requirements that apply to the audit are the ICAI's Code of Ethics and the provisions of the Companies Act, 2013.*
- *Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with SA 570 (Revised).*
- *Between the date of the financial statements and the date of the auditor's report, there was a fire in the entity's production facilities, which was disclosed by the entity as a subsequent event. In the auditor's judgment, the matter is of such importance that it is fundamental to users' understanding of the financial statements. The matter did not require significant auditor attention in the audit of the financial statements in the current period.*
- *The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with SA 701.*
- *Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.*
- *In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under the Companies Act, 2013.*

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

#### **Qualified Opinion**

We have audited the standalone financial statements of ABC Limited ("the Company"), which comprise the balance sheet as at March 31, 20X1, and the statement of Profit and Loss, (statement of changes in equity) and the statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information (in which are included the Returns for the year ended on that date audited by the branch auditors of the Company's branches located at *(location of branches)*)<sup>2</sup>.

In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in the *Basis for Qualified Opinion* section of our report, the aforesaid financial statements present fairly, in all material respects, or *give a true and fair view* in conformity with the accounting principles generally accepted in India of the state of affairs of the Company as at March 31<sup>st</sup>, 2XXX and profit/loss, (*changes in equity*) and its cash flows for the year ended on that date.

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<sup>15</sup> The sub-title "Report on the Audit of the Standalone Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

### Basis for Qualified Opinion

The Company's short-term marketable securities are carried in the statement of financial position at xxx. Management has not marked these securities to market but has instead stated them at cost, which constitutes a departure from the Accounting Standards prescribed in section 133 of the Companies Act, 2013. The Company's records indicate that had management marked the marketable securities to market, the Company would have recognized an unrealized loss of ₹xxx in the statement of comprehensive income for the year. The carrying amount of the securities in the statement of financial position would have been reduced by the same amount at March 31, 20X1, and income tax, net income and shareholders' equity would have been reduced by ₹xxx, ₹xxx and ₹xxx, respectively.

We conducted our audit in accordance with Standards on Auditing (SAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements under the provisions of the Companies Act, 2013, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the ICAI's Code of Ethics. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

### Emphasis of Matter – Effects of a Fire

We draw attention to Note X of the financial statements, which describes the effects of a fire in the Company's production facilities. Our opinion is not modified in respect of this matter.

**Note: Students may refer remaining paras of Audit Report like Key Audit Matters para etc., from the illustrative format given above.**

## TEST YOUR KNOWLEDGE

### Theoretical Questions

1. Under the applicable Standards on Auditing, in what circumstances does the report of the statutory auditor require modifications? What are the types of modifications possible to the said report?
2. Write a short note on Emphasis of matter paragraph in Audit Reports.
3. Write a short note on Certificate for Special Purpose vs. Audit Report.
4. Compare and explain the following:
  - (i) Reporting to Shareholders vs. Reporting to those Charged with Governance
  - (ii) Audit Qualification vs. Emphasis of Matter.

### Multiple Choice Questions

1. KPI Ltd is a joint venture of KPI Inc, a company based in US, and OPQ Ltd, a company based in Japan (hereinafter referred to as 'JV partners'). KPI Ltd was registered in India and is operating as a marketing support company for KPI Inc. All the costs of KPI Ltd are incurred in India and entire revenue of KPI Inc is generated in USD. The entire funding requirements of KPI Ltd are taken care of by the JV partners. Since KPI Ltd is based in India, hence it is also required to get its financial statements audited.

The company appointed new auditors for the audit of the financial statements for the year ended 31 March 2019 after doing all appointment formalities wherein auditors also confirmed their eligibility for appointment including independence.

The statutory auditors have completed their audit and did not come up any significant observations. Management of KPI Ltd was also very pleased with the working style of the auditors.

When the auditors issued their final audit report, the management observed that the auditors did not state anything related to their compliance in respect of ethical requirements regarding independence etc. Further, the audit report was also silent on the requirement related to auditor's communication with those charged with governance in respect of matters related to planned scope & timing of audit and any significant findings.

The management requested that the auditors should revisit their report and should include these points in their report, however, as per the auditors all these communications were already completed by them and hence they were not required to form part of the audit report.

On the basis of above mentioned facts, please suggest which of the following should be correct.

- (a) The auditing standards do not require the auditors to comment on the points which the management is requesting i.e. ethical requirements or matters related to planned scope & timing of audit or any significant findings etc. However, if the auditor wants to include that on the basis of his agreed terms with the management, he may do so.
- (b) The auditing standards require the auditors to comment on the points which the management is requesting i.e. ethical requirements or matters related to planned scope & timing of audit or any significant findings etc. Hence, the auditors should issue rectified report.
- (c) The ethical requirements are already completed by the auditors at the time of appointment itself. Since the audit is completed, there is no need to comment on the planned scope & timing of audit. Since there are no significant findings so this communication is also not possible. Hence, the auditors need not revisit their report.
- (d) The ethical requirements are already completed by the auditors at the time of appointment itself and there are no significant findings, hence, there is no need to comment on these points. However, the auditors should state that they communicate with those charged with governance regarding the planned scope & timing of audit. Therefore, the auditors should revisit their report.

2. LMN & Co LLP is a large firm of Chartered Accountants having its offices based in Delhi, Pune, Chandigarh and Bangalore.

The firm has staff of around 300 with 28 Partners. The firm has also created various departments for various services that it offers – statutory audit, risk advisory, mergers & acquisitions, indirect tax and direct tax, where dedicated teams are working who are specialized in those fields. The firm is also considering to create departments on the basis of industry sectors so that the staff can become specialized into specific industries as the same would help in the objective of the firm i.e. to offer best quality service to its various clients.

Statutory audit department of the firm has 13 partners across various offices in India out of which 6 are based in Delhi office.

The audit team of one of the prestigious clients, KSH Ltd, has concluded that audit where audit partner was AD Jain. As per the agreed timelines, the financial statements and the audit report were planned to be signed on 30 June, 2019, however, on 29 June, 2019, AD Jain was required to move out of India due to some exigency and would be back to India after a month's time. He was also not accessible during this period.

The management of KSH Ltd discussed the matter with another partner of the audit firm, SK Gupta, who eventually signed the audit report on 30 June, 2019 even though he was not part of the audit team which was involved in the fieldwork.

We would like to understand your views in respect of this matter.

- (a) The management in such a case should have waited for AD Jain to come back and then get the report signed. The audit report in this case would be considered to be invalid.
- (b) SK Gupta signed the audit report considering the client was prestigious for the firm which was unethical.
- (c) Signing of the audit report as per the agreed timelines by SK Gupta was fine as he was also the audit partner of the firm.
- (d) Signing of audit report by any other person interferes with the concept of clarity of responsibility.

3. RBJ Ltd is a listed company engaged in the business of software and is one of the largest company operating in this sector in India. The company's annual turnover is INR 40,000 crores with profits of INR 5,000 crores. Due to the nature of the business and the size of the company, the operations of the company are spread out in India as well as outside India.

Outside India, the company is focusing more on US and European markets and the company has been able to establish its good reputation in these markets as well.

During the course of the audit, the audit team spends significant time on audit of revenue – be it planning, execution or conclusion. The audit team for this engagement is generally very big i.e. a team of approx. 70-80 members. The company's contracts with its various customers are quite complicated and different. The efforts towards audit of revenue also involve significant involvement of senior members of the audit team including the audit partner.

After completion of audit for the year ended 31 March 2019, the audit partner was discussing significant matters with the management wherein he also communicated to the management that he plans to include revenue recognition as key audit matter in his audit report. The management was quite surprised to understand this from the auditor and did not agree with revenue recognition to be shown as key audit matter in the audit report. As per the management, the auditors didn't have any modification and such a matter getting reported as key audit matter would not go down well with various stakeholders and would significantly impact the financial positions of the company in the market. The auditors were not able to convince the management in respect of this point and there was a difference of opinion.

You are requested to give your view in respect of this matter.

- (a) The concern of the management is valid. For such a large sized company, such type of matter getting reported as key audit matter is not appropriate.
  - (b) The assessment of the auditor is valid. Such a matter qualifies to be a key audit matter and hence should be reported accordingly by the auditor in his audit report.
  - (c) Reporting revenue as key audit matter when the auditor does not have observation in that area leading to any modification in his report, would not be appropriate.
  - (d) This being the first year of reporting of key audit matters, the auditor should take a soft stand and should avoid reporting such controversial matters in his report.
4. BDJ Ltd is engaged in the business of providing management consultancy services and have been in operation for the last 15 years. The company's financial reporting process is very good and its statutory auditors always issued clean report on the audit of the financial statements of the company. The auditors were required to be rotated due to mandatory audit rotation requirement of the Companies Act 2013.

RNJ & Associates, a firm of Chartered Accountants, was appointed as the new auditor of the company for a term of 5 years and have to start their first audit for the financial year ended 31 March 2019.

The auditors had a detailed and clear discussion with the management that they will perform their audit procedures in respect of opening balances along with the audit procedures for the financial year ended 31 March 2019.

Management agreed with that and the audit was completed as per the plan.

The auditors did not have any significant observations and hence they communicated to the management that their report will be clean. Management was quite happy with this and also requested the auditors to share draft report before issuing the final report.

In the draft audit report, all the particulars were fine except 'other matters paragraph' wherein the auditors gave a reference that the financial statements for the comparative year ended 31 March 2018 was audited by another auditor. Management asked the audit team to remove this paragraph as the auditors had performed all the audit procedures on opening balances also. But the auditors did not agree with the management.

Please advise the auditor or the management whoever is incorrect with the right guidance.

- (a) The contention of the management is valid. After performing all the audit procedures, an auditor should not pass on the responsibility to another auditor by including such references in his audit report.
- (b) Any auditor has two options, either to perform audit procedures on opening balances or given such reference of another auditor in his report. An auditor can not mix up the things like this auditor has done. It is completely unprofessional.

- (c) In the given situation even if the auditor wants to give such reference, the management and the auditor should have taken approval from the previous auditor at the time of appointment of new auditor. In this case, it cannot be done.
  - (d) The report of the auditor is absolutely correct and is in line with the auditing standards. An auditor is required to include such reference in his report as per the requirements of the auditing standard.
5. SKJ Private Ltd has an annual turnover of INR 200 crores and profits of INR 25 crores. The company is engaged in the business of textiles and has fairly stable operations over the years. There has not been much growth in the company in the last few years despite the attempts of the management. Currently the management is more focused towards cost cutting and has been considering all the options to achieve that objective.

The statutory auditors of the company have been auditing the financial statements for the last 3 years and have issued clean reports over these years.

During the financial year ended 31 March 2019, management got a large project from a new customer which resulted in significant increase in the turnover of the company. However, the profitability of the company did not improve much because the margins in the contract were not high.

The statutory auditors during the course of their audit of financial statements for the year ended 31 March 2019 (their fourth year of audit) did not agree with the revenue recognition criteria followed by the company. Since the matter was significant, lot of discussions/debates happened between the auditor and the management. But it was finally agreed that the auditors would qualify their audit report.

Auditors wanted that the management should explain this matter in detail in the notes to accounts to the financial statement over which the auditors are qualifying the audit report. However, the management had a different view. Management said that if the auditor is qualifying his report then why should the management also highlight that matter in the financial statement and hence refused to include any note for the same.

Because of this conflict, audit is not getting concluded. You are requested to give your view in respect of this matter so that the matter gets concluded.

- (a) In the given situation, if the management does not agree to give a note in the financial statements then the auditor should not hold the audit report. However, in such a case, the auditor would need to give disclaimer of opinion in his report instead of qualification.
- (b) The argument of the management seems correct. Auditor cannot do both the things i.e. to qualify and then also get that highlighted in the financial statements. That note would not be beneficial for the users of the financial statements.

- (c) In case of such matters related to revenue recognition, it is always better to give detailed explanation in the notes to accounts to the financial statements. If the explanation is satisfactory then the auditor should also consider giving emphasis of matter instead of qualification.
  - (d) The requirement of the auditor is beneficial for the company because by giving an explanation of the matter, on which auditor has given a qualification, in the notes to accounts, the management would be able to explain their perspective/ point of view to the users of the financial statements. In that case, auditor while giving the qualification can give reference to the notes to accounts otherwise the entire matter would form part of the audit report. However, the auditor should not hold his report if the management does not want to give any explanation in the notes to accounts.
6. While conducting the current year audit of Finco Ltd, the auditor obtains audit evidence that a material misstatement exists in the prior period financial statements. This misstatement was related to recognition of research and development expenditure. The provisions of Ind AS 38 Intangible Assets relating to capitalisation of development expenditure was not applied properly. On this, unmodified opinion had been previously issued. The current auditor verified that the misstatement had not been dealt with as required under Ind AS 8 Accounting Policies, Changes in Accounting Estimates and Errors. Accordingly, the current auditor will:
- (a) Express an unmodified opinion in the auditor's report on the current period financial statements since it was related to the prior year.
  - (b) Express a qualified opinion in the auditor's report on the current period financial statements, modified with respect to the corresponding figures included therein.
  - (c) Express a qualified or an adverse opinion in the auditor's report on the current period financial statements modified with respect to the corresponding figures included therein.
  - (d) Express an adverse opinion in the auditor's report on the current period financial statements, modified with respect to the corresponding figures included therein.

### Answers to Theoretical Questions

1. Refer Para 5.
2. Refer Para 6.
3. **Certificate for Special Purpose vs. Audit Report:** A certificate is a written confirmation of the accuracy of the facts stated therein and does not involve any estimate or opinion. The term 'certificate' is, therefore, used where the auditor verifies the accuracy of facts. An auditor may thus, certify the circulation figures of a newspaper or the value of imports or exports of a company. An auditor's certificate represents that he has verified certain figures

and is in a position to vouch safe their accuracy as per his examination of documents and books of account. A report, on the other hand, is a formal statement usually made after an enquiry, examination or review of specified matters under report and includes the reporting auditor's opinion thereon. Thus, when a reporting auditor issues a certificate, he is responsible for the factual accuracy of what is stated therein. On the other hand, when a reporting auditor gives a report, he is responsible for ensuring that the report is based on factual data, that his opinion is in due accordance with facts, and that it is arrived at by the application of due care and skill. The 'report' involves expression of opinion which may differ from one professional to another. There is no question of exactitude in case of a report since the information contained therein is based on estimates and involves judgement element.

4. (i) **Reporting to Shareholders vs. Reporting to those Charged with Governance:**

REPORT	
Reporting to Shareholders	Reporting to those Charged with Governance
<ul style="list-style-type: none"> <li>Section 143 of the Companies Act, 2013 deals with the provisions relating to reporting to Shareholders. Thus, it is a Statutory Audit Report which is addressed to the members.</li> </ul>	<ul style="list-style-type: none"> <li>Standard on Auditing 260 deals with the provisions relating to reporting to those Charged with Governance.</li> </ul>
<ul style="list-style-type: none"> <li>Statutory Audit Report is on true and fair view and as per prescribed Format.</li> </ul>	<ul style="list-style-type: none"> <li>It is a reporting on matters those charged with governance like scope of audit, audit procedures, audit modifications, etc.</li> </ul>
<ul style="list-style-type: none"> <li>Statutory Audit Reports are in public domain.</li> </ul>	<ul style="list-style-type: none"> <li>Reporting to those Charged with Governance is an internal document i.e. private report.</li> </ul>

(ii) **Audit Qualification vs. Emphasis of Matter:**

REPORT	
Audit Qualification	Emphasis of Matter
<ul style="list-style-type: none"> <li>Standard on Auditing 705 "Modifications to the Opinion in the Independent Auditor's Report", deals with the provisions relating to Audit Qualification.</li> </ul>	<ul style="list-style-type: none"> <li>Standard on Auditing 706 "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report" deals with the provisions relating to Emphasis of Matter.</li> </ul>
<ul style="list-style-type: none"> <li>Audit Qualifications are also known as "subject to report" or "except that report".</li> </ul>	<ul style="list-style-type: none"> <li>Emphasis of Matter is a paragraph which is included in auditor's report to draw users' attention to important matter(s) which are already disclosed</li> </ul>

	in Financial Statements and are fundamental to users' for understanding of Financial Statements.
<ul style="list-style-type: none"> <li>• Audit Qualifications are given when auditor is having reservations on some of the items out of the financial statements as a whole i.e. Auditor's Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements relating to if the impact of material misstatements is not pervasive on the financial statements but is present at some levels of the financial statements, qualified report is issued.</li> </ul>	<ul style="list-style-type: none"> <li>• Emphasis of Matter is a paragraph which is issued when there is a uncertainty relating to future outcome of exceptional litigation, regulatory action, etc.; or there is early application (where permitted) of a new accounting standard that has a pervasive effect on the financial statements in advance of its effective date.</li> </ul>

### Answers to Multiple Choice Questions

1. (b)    2. (c)    3. (b)    4. (d)    5. (d)    6. (c)