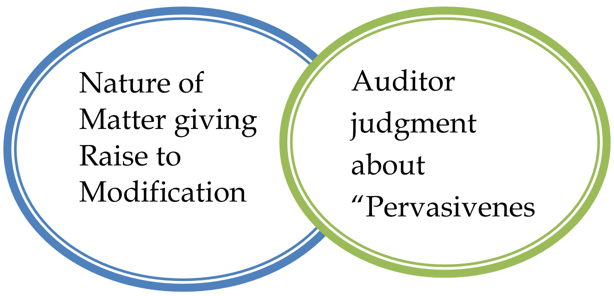
**SUMMARY ON SA-705**
**MODIFICATION TO THE OPINION IN THE INDEPENDENT AUDIT REPORT**

Auditor's responsibility to issue an appropriate report in circumstances when, the auditor concludes that modification to audit report is necessary.

**Auditor modified opinion based on following factors**




**Meaning of pervasiveness:** A term used in the context of material misstatements, to describe the effect / possible effect on financial statements because of

a) Undetected due to inability to obtain sufficient appropriate audit evidence.

**Meaning of modified opinion:** Qualified opinion, adverse opinion & disclaimer opinion.

| *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 |

**Necessary changes to be made in Auditor's report when auditor expresses modified opinion**

**In case of qualified opinion:** The auditor shall amend the "auditor responsibility" paragraph by stating that auditor has obtained sufficient appropriate audit evidence to provide the basis for "Qualified o pinion".

**In case of adverse opinion:** The auditor shall amend "introductory paragraph" & "auditor responsibility paragraph"

**Introductory paragraph:** Use words "We are engaged to audit the financial statements"

**Auditor responsibility paragraph:** Use words "Our responsibility is to express the opinion on F/s because of matters prescribed in opinion paragraph we are not able to obtain sufficient appropriate audit evidence.

"Communicate to those who charged with governance
**Before issuing a report with following issues**

**a) Circumstances led to expected modification**
**b) Proposed wordings**

**Procedure for communication to TCWG**

1. The auditor should give notice to TCWG
2. Seek the concurrence from TCWG
3. TCWG to have an opportunity to provide the auditor further information & explanation

**As per SA-450 a material misstatement of the financial statement may arise due to following**

Appropriateness Selected A/c policies

Application of selected selected a/c polices

Appropriateness/adequacy of disclosures

**Nature of inability to obtain sufficient appropriate audit evidence**

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

A10. Examples of circumstances beyond the control of the entity include when:

- The entity's accounting records have been destroyed.
- The accounting records of a significant component have been seized indefinitely by governmental authorities.

A11. Examples of circumstances relating to the nature or timing of the auditor's work include when:

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

A12. Examples of an inability to obtain sufficient appropriate audit evidence arising from a limitation on the scope of the audit imposed by management include when:

- Management prevents the auditor from observing the counting of the physical inventory.
- Management prevents the auditor from requesting external confirmation of specific account balances.

**Consequence of inability to obtain sufficient appropriate audit evidence**

**If majority portion of audit completed:** Auditor decides to complete audit, "Disclaim an opinion" & Basis for disclaimer opinion has to be stated

**Circumstances not possible to resign from audit:** include in "Other matter paragraph"
(Refer ICAI material for more examples)

**<u>Student notes:</u>**

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

Auditor is required to express his opinion in the form of a written report called auditor's report. Although auditor's responsibility and also the purpose of auditor's report is to convey primarily the auditor's opinion on financial statements but if auditor believes that there is a matter that must be brought to attention of user of financial statements then he do so by adding either or both of additional paragraphs called **emphasis of matter** and **other matter** paragraph.

In short the purpose of both paragraphs is to **draw user's attention to important piece of information** that can help understand financial statements better. The **distinguishing factor between two paragraphs is that one (emphasis of matter) is about the matters already disclosed in the financial statements and the second (other matter) is about matters that are not disclosed in the financial statements.**

**Important points to be noted**

1) Inclusion of any or both **will not result in modification of auditor's opinion**. However, these paragraphs can be used **even if opinion is modified**.
2) These paragraphs are included **after opinion paragraph** in the auditor's report.
3) If auditor intends to add both paragraphs in the same report then after opinion paragraph **emphasis of matter paragraph will be added** and **subsequently other matter paragraph**.
4) Auditor shall discuss the wordings of paragraph with those charged with governance.

**Example**

**Emphasis of Matter**
We draw attention to Note X to the financial statement which describes the Uncertainty related to the outcome of the lawsuit filed against the Company by XYZ Company. Our opinion is not qualified in respect of this matter.

**Other Matter**
We did not audit the financial statements of certain subsidiaries, whose financial statements reflect total assets (net) of Rs. XXXX as at March 31, 20XX, total revenues of Rs. XXXX and net cash outflows amounting to Rs. XXXX for the year then ended. These financial statements have been audited by other auditors whose reports have been furnished to us by the Management, and our opinion is based solely on the reports of the other auditors. Our opinion is not qualified in respect of this matter.

**(Refer ICAI material for more expamples)**

**Student notes:**