Agenda Item 7-B

PROPOSED INTERNATIONAL STANDARD ON AUDITING 705

(REVISED AND REDRAFTED)

MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT

(Effective for audits of financial statements for periods beginning on or after [date][*])

[CLEAN VERSION]

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[*] See footnote 1.

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

Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor's responsibility to issue an appropriate report in circumstances when a modification to the auditor's opinion on the financial statements is required.

2. A modification to the auditor's opinion may be required in the circumstances of an engagement to report on general purpose financial statements prepared and presented in accordance with a fair presentation or compliance framework, or an engagement to report on special purpose financial statements or specific elements, accounts or items of a financial statement. The requirements and guidance in this ISA are established in the context of engagements to report on general purpose financial statements prepared and presented in accordance with a fair presentation framework. In all other cases, these requirements and guidance are to be applied, adapted as necessary.

3. This ISA does not apply to engagements covered by [proposed] ISA 805 (Revised and Redrafted), "Special Considerations when Reporting on Summary Financial Statements," which establishes requirements and provides guidance when the auditor modifies the opinion on summary financial statements derived from financial statements audited by the auditor.

Types of Modified Opinions

4. This ISA establishes three types of modified opinions, namely, a qualified opinion, an adverse opinion, and a disclaimer of opinion. The decision regarding which type of modified opinion is appropriate depends upon:

   (a) The nature of the matter giving rise to the modification, i.e. whether the financial statements are materially misstated or whether there is an inability to obtain sufficient appropriate audit evidence; and

   (b) The auditor's judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements.

5. The table below illustrates how the auditor's judgment about the nature of the matter giving rise to the modification, and the pervasiveness of its effects or possible effects on the financial statements, affects the type of opinion to be expressed.

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

Effective Date

6. This ISA is effective for audits of financial statements for periods beginning on or after [date].[1]

Objective

7. The objective of the auditor is to express clearly and appropriately the modified opinion on the financial statements that is necessary:

   (a) When the auditor concludes that the financial statements are not free from material misstatement; or

   (b) When the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements are free from material misstatement.

Definitions

8. For purposes of the ISAs, the following terms have the meanings attributed below:

   (a) Pervasive misstatements – Misstatements that are material individually or in the aggregate are pervasive to the financial statements when, in the auditor's judgment, such misstatements are not confined to specific elements, accounts or items in the financial statements or, if confined, the misstatements represent or could represent a substantial proportion of the financial statements. Further, in relation to disclosures, misstatements that are material individually or in the aggregate are pervasive when, in the auditor's judgment, the misstated disclosures are fundamental to users' understanding of the financial statements; and

   (b) Material and pervasive inability to obtain sufficient appropriate audit evidence – An inability to obtain sufficient appropriate audit evidence about one or more matters pertaining to the financial statements is both material and pervasive when, in the auditor's judgment, the possible effects of the inability cannot be confined to

[1] This date will not be earlier than December 15, 2008.

specific elements, accounts or items in the financial statements or, if confined, those possible effects could represent a substantial proportion of the financial statements.

Requirements

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

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

   (a) The auditor concludes that, based on the audit evidence obtained, the financial statements are not free from material misstatement; or (Ref: Para. A1-A5)

   (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements are free from material misstatement. (Ref: Para. A6-A10)

Determining the Type of Modification to the Auditor's Opinion

Qualified Opinion

10. The auditor shall express a qualified opinion:

    (a) When the auditor concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or

    (b) When the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the possible effects on the financial statements of that inability are material but not pervasive.

Adverse Opinion

11. The auditor shall express an adverse opinion when the auditor concludes that misstatements are pervasive to the financial statements.

Disclaimer of Opinion

12. The auditor shall disclaim an opinion on the financial statements when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the possible effects on the financial statements of that inability are both material and pervasive. (Ref: Para. A11)

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

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

14. If management refuses the auditor's request to remove a limitation that management has imposed on the scope of the audit, the auditor shall communicate the matter with those charged with governance and determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence on which to base an unmodified opinion. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall determine the implications as follows:

(a) If the possible effects of the scope limitation are material but not pervasive to the financial statements, the auditor shall qualify the opinion; or

(b) If the possible effects of the scope limitation are both material and pervasive to the financial statements so that a qualification of the opinion would be inadequate to communicate the gravity of the situation:

(i) The auditor shall resign from the audit; or (Ref: Para. A12)

(ii) If resignation from the audit before issuing the auditor's report is not practicable or possible, the auditor shall disclaim an opinion. (Ref: Para. A13)

15. If the auditor concludes that resignation from the audit is necessary because of a scope limitation imposed by management, the auditor shall communicate to those charged with governance before resigning any matters of which the auditor has become aware that would have given rise to a modification of the opinion regarding misstatements identified during the audit.

Prohibition on Issuing a Piecemeal Opinion

16. If the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements as a whole, the auditor shall not express an unmodified opinion on one or more specific elements, accounts or items in the financial statements in the same report and with respect to the same applicable financial reporting framework (a "piecemeal opinion"). (Ref: Para. A14-A16)

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

Basis for Modification Paragraph

17. When the auditor modifies the opinion on the financial statements, the auditor shall, in addition to the specific elements required by [Proposed] ISA 700 (Redrafted), include a paragraph in the auditor's report that provides a description of the matter giving rise to the modification. The auditor shall place this paragraph immediately before the opinion paragraph in the auditor's report and use the heading "Basis for Qualified Opinion," Basis for Adverse Opinion," or "Basis for Disclaimer of Opinion," as appropriate. (Ref: Para. A17)

18. If there is a material misstatement of the financial statements that relates to specific amounts in the financial statements (including quantitative disclosures), the auditor shall include in the basis for modification paragraph 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 the basis for modification paragraph. (Ref: Para. A18)

19. If there is a material misstatement of the financial statements that relates to narrative disclosures, the auditor shall include in the basis for modification paragraph an explanation of how the disclosures are misstated.

20. 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 describe in the basis

for modification paragraph the nature of the omitted information and, 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. (Ref: Para. A19-A20)

21. If the modification results from an inability to obtain sufficient appropriate audit evidence, the auditor shall include in the basis for modification paragraph the reasons for that inability.

22. 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 modification paragraph the reasons for any other matters that would have required a modification to the opinion, and the effects thereof. (Ref: Para. A21)

Opinion Paragraph

23. 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 paragraph. (Ref: Para. A22, A24-A25)

24. When the auditor expresses a qualified opinion, the auditor shall state in the opinion paragraph that, in the auditor's opinion, except for the effects of the matter(s) described in the Basis for Qualified Opinion paragraph, the financial statements give a true and fair view (or "present fairly, in all material respects") in accordance with the applicable financial reporting framework. When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor shall use the corresponding phrase "except for the possible effects of the matter(s) ..." for the modified opinion. (Ref: Para. A23)

25. When the auditor expresses an adverse opinion, the auditor shall state in the opinion paragraph that, in the auditor's opinion, because of the significance of the matter(s) described in the Basis for Adverse Opinion paragraph, the financial statements do not give a true and fair view (or "do not present fairly") in accordance with the applicable financial reporting framework.

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

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

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

Description of Auditor's Responsibility when the Auditor Disclaims an Opinion

28. When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor shall amend the introductory paragraph of the auditor's report to state that the auditor was engaged to audit the financial statements. The auditor shall also amend the description of the auditor's responsibility and the description of the scope of the audit to state only the following: "Our responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with International Standards on Auditing. Because of the matter(s) described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion."

Communication with Those Charged with Governance

29. 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 lead to the expected modification and the proposed wording of the modification. (Ref: Para. A26)

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Application and Other Explanatory Material

Nature of Material Misstatements (Ref: Para. 9(a))

A1. A material misstatement of the financial statements may arise in relation to:

(a) The appropriateness of the selected accounting policies;

(b) The application of the selected accounting policies; or

(c) The appropriateness or adequacy of disclosures in the financial statements.

Appropriateness of the Selected Accounting Policies

A2. In relation to the appropriateness of the accounting policies management has selected, material misstatements of the financial statements may arise when:

- The selected accounting policies are not consistent with the applicable financial reporting framework.
- The selected accounting policies are not appropriate in the circumstances and, accordingly, the overall presentation of, and disclosures in, the financial statements are not consistent with the auditor's understanding of the entity and its environment.
- Because of the accounting policies selected by management, the financial statements, including the related explanatory notes, do not faithfully represent the underlying transactions and events in a manner that achieves fair presentation.

A3. Financial reporting frameworks often contain requirements for the accounting for, and disclosure of, changes in accounting policies. Where the entity has changed its selection of significant accounting policies, a material misstatement of the financial statements may arise when the entity has not complied with these requirements.

Application of the Selected Accounting Policies

A4. In relation to the application of the selected accounting policies, material misstatements of the financial statements may arise:

- When management has not applied the selected accounting policies consistently with the financial reporting framework, including when management has not applied the selected accounting policies consistently between periods or to similar transactions and events (consistency in application); or
- Due to the method of application of the selected accounting policies (such as an unintentional error in application), or when there is a disagreement with management about the underlying facts and circumstances to which the selected accounting policies are applied (for example, a disagreement about estimates for pension liabilities).

Appropriateness or Adequacy of Disclosures in the Financial Statements

A5. In relation to the appropriateness or adequacy of disclosures in the financial statements, material misstatements of the financial statements may arise when:

(a) The financial statements do not include all of the disclosures required by the applicable financial reporting framework;

(b) The disclosures in the financial statements are not presented in accordance with the applicable financial reporting framework; or

(c) The financial statements do not provide the disclosures necessary to achieve fair presentation.

Nature of an Inability to Obtain Sufficient Appropriate Audit Evidence (Ref: Para. 9(b))

A6. The auditor's inability to obtain sufficient appropriate audit evidence (also referred to as a limitation on the scope of the audit) may arise from:

(a) Circumstances beyond the control of the entity;

(b) Circumstances relating to the nature or timing of the auditor's work; or

(c) Limitations imposed by management.

A7. An inability to perform a specific procedure does not constitute a scope limitation if the auditor is able to obtain sufficient appropriate audit evidence by performing alternative procedures. If this is not possible, the requirements of paragraphs 10(b) and 12 apply as appropriate. Limitations imposed by management may have other implications for the audit, for example, the auditor's assessment of fraud risks and consideration of engagement continuance.

A8. Examples of circumstances beyond the control of the entity include:

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

A9. 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.
- When the timing of the auditor's appointment is such that the auditor is unable to observe the counting of the physical inventories.
- When the auditor determines that performing substantive procedures alone are not sufficient, but the entity's controls are not effective.

A10. Examples of an inability to obtain sufficient appropriate audit evidence arising from a scope limitation imposed by management include:

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

Disclaimer of Opinion in the Case of Multiple Uncertainties (Ref: Para. 12)

A11. In cases involving multiple uncertainties, the auditor may conclude in extremely rare circumstances that it is not possible to form an opinion on the financial statements as a whole due to the interaction and cumulative possible effects of the uncertainties, even though the auditor has obtained sufficient appropriate audit evidence about management's assertions regarding each of the individual uncertainties. The auditor is not precluded from disclaiming an opinion in such a situation.

Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence due to a Management-imposed Limitation After the Auditor has Accepted the Engagement (Ref: Para. 14)

A12. The timing of the auditor's resignation may depend upon the stage of completion of the engagement when management imposes the scope limitation. If the auditor has substantially completed the audit, the auditor may decide to complete the audit to the extent possible, disclaim an opinion and explain the scope limitation in the Basis for Disclaimer of Opinion paragraph prior to resigning.

A13. In certain circumstances, resignation from the audit may not be possible if the auditor is required to continue the audit engagement by law or regulation. This may be the case for national audit agencies that are appointed to audit the financial statements of public sector entities, or in jurisdictions where the auditor is appointed for a specific period and is prohibited from resigning before the end of that period. In such cases, paragraph 14(b)(ii) requires the auditor to disclaim an opinion on the financial statements.

Prohibition on Issuing a Piecemeal Opinion (Ref: Para. 16)

A14. For the purpose of this ISA, a piecemeal opinion arises when the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements as a whole and, in the same report, expresses an unmodified opinion on one or more specific elements, accounts or items in the financial statements with respect to the same financial reporting framework.

A15. Specific elements, accounts or items in the financial statements may include, for example, the revenue item in the income statement, or specific disclosures in the financial statements. A combination of an unmodified opinion on one or more of these specific elements, accounts or items, and an adverse opinion or a disclaimer of opinion on the financial statements as a whole, in the same report and with respect to the same financial reporting framework, is contradictory. It is accordingly not permitted.

A16. The description of "piecemeal opinion" in paragraph A14 does not include, for example:

- The expression of an unmodified opinion on financial statements prepared under a given financial reporting framework and, within the same report, the expression of an adverse opinion or the issue of a disclaimer of opinion on the same financial statements under a different financial reporting framework. For example, the auditor may express an adverse opinion on financial statements prepared in accordance with a financial reporting framework designed to achieve fair presentation, and within the same report, express an unmodified opinion with respect to the proper preparation of the financial statements in accordance with specific legal requirements not designed to achieve fair presentation.
- The expression of an unmodified opinion on the closing financial position of the entity but a disclaimer of an opinion on the results of operations and cash flows if the auditor has been unable to obtain sufficient audit evidence concerning the entity's opening balances (see paragraph [A7] of [proposed] ISA 510 (Redrafted), "Initial Engagements–Opening Balances").

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

Basis for Modification Paragraph (Ref: Para. 17-22)

A17. Consistency in the auditor's report helps to promote the users' understanding and to identify unusual circumstances when they occur. Accordingly, although uniformity in the wording of a modified opinion and in the description of the basis for the modification may not be possible, consistency in both the form and content of the auditor's report is desirable.

A18. An example of the financial effects of material misstatements that the auditor may describe in the basis for modification paragraph in the auditor's report is the quantification of the effects on income tax, net income and equity if inventory is overstated.

A19. Disclosing the omitted information in the basis for modification paragraph would not be practicable if:

(a) The auditor would be assuming management's responsibility for the preparation of the omitted disclosures; or

(b) In the auditor's judgment, the disclosures would be unduly voluminous in relation to the auditor's report.

A20. The auditor may be assuming management's responsibility for the preparation of the omitted disclosures if the omitted disclosures have not been prepared by management or are otherwise not readily available to the auditor.

A21. An adverse opinion or a disclaimer of opinion does not justify the omission of a description of other identified matters that would require a modification, for example misstatements regarding the recognition, measurement, or disclosure of certain assets and liabilities (for example, the existence of inventory).

Opinion Paragraph (Ref: Para. 23-24)

A22. Inclusion of this paragraph heading makes it clear to the user that the auditor's opinion is modified and indicates the type of modification.

A23. When the auditor expresses a qualified opinion, 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.

Illustrative Auditors' Reports

A24. Example Reports 1 and 2 in the Appendix illustrate auditors' reports containing qualified and adverse opinions, respectively, when the financial statements are materially misstated.

A25. Example Report 3 in the Appendix illustrates an auditor's report containing a qualified opinion when the auditor is unable to obtain sufficient appropriate audit evidence. Example Report 4 in the Appendix illustrates a disclaimer of opinion due to an inability to obtain sufficient appropriate audit evidence about a single element in the financial statements. Example Report 5 illustrates a disclaimer of opinion due to an inability to obtain sufficient appropriate audit evidence about multiple elements in the financial statements. In each of the latter two cases, the possible effects on the financial statements of the inability are both material and pervasive.

Communication with Those Charged with Governance (Ref: Para. 29)

A26. Communicating with those charged with governance the circumstances that lead to an expected modification to the auditor's opinion and the proposed wording of the modification enables:

(a) The auditor to give notice to those charged with governance of the intended modification(s) and the reasons (or circumstances) for the modification(s);

(b) The auditor to seek the concurrence of those charged with governance regarding the facts of the matter(s) giving rise to the expected modification(s), or to confirm matters of disagreement with management as such; and

(c) Those charged with governance to have an opportunity, where appropriate, to provide the auditor with further information and explanations in respect of the matter(s) giving rise to the expected modification(s).

Appendix

Examples of Auditors' Reports with Modifications to the Opinion

Example Report 1: Auditor's report with a qualified opinion due to a misstatement relating to inventories. The misstatement is deemed to be material but not pervasive to the financial statements.

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements[2]

We have audited the accompanying financial statements of ABC Company, which comprise the balance sheet as at December 31, 20X6, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of

[2] The subheading "Report on the Financial Statements" is unnecessary in circumstances when the second subheading "Report on Other Legal and Regulatory Requirements" is not applicable.

expressing an opinion on the effectiveness of the entity's internal control.[2] An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

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 International Financial Reporting Standards. 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' equity would have been reduced by xxx, xxx and xxx, respectively.

Qualified Opinion

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements give a true and fair view of (*or "present fairly, in all material respects,"*) the financial position of ABC Company as at December 31, 20X6, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Report on Other Legal and Regulatory Requirements

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

[*Auditor's signature*]

[*Date of the auditor's report*]

[*Auditor's address*]

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

Example Report 2: Auditor's report with an adverse opinion due to a material misstatement relating to the non-consolidation of a subsidiary. The material misstatement is deemed to be pervasive to the financial statements.

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements[3]

We have audited the accompanying financial statements of ABC Company, which comprise the balance sheet as at December 31, 20X6, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit 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.[4] An audit also includes evaluating the appropriateness of accounting policies used and the

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[3] The subheading "Report on the Financial Statements" is unnecessary in circumstances when the second subheading "Report on Other Legal and Regulatory Requirements" is not applicable.

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

reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Basis for Adverse Opinion

As explained in Note X, the company has not consolidated the financial statements of subsidiary XYZ Company it acquired during 20X6. This investment is accounted for on a cost basis. Under International Financial Reporting Standards, the subsidiary should have been consolidated because it is controlled by the company. Had XYZ been consolidated, many elements in the accompanying financial statements would have been materially affected.

Adverse Opinion

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion paragraph, the financial statements do not give a true and fair view of *(or "do not present fairly")* the financial position of ABC Company as at December 31, 20X6, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Report on Other Legal and Regulatory Requirements

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

[*Auditor's signature*]

[*Date of the auditor's report*]

[*Auditor's address*]

Example Report 3: Auditor's report with a qualified opinion due to the auditor's inability to obtain sufficient appropriate audit evidence regarding an investment in a foreign affiliate. The possible effects of the inability to obtain sufficient appropriate audit evidence are deemed to be material, but not pervasive to the financial statements.

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements[5]

We have audited the accompanying financial statements of ABC Company, which comprise the balance sheet as at December 31, 20X6, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit 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.[6] An audit

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5 The subheading "Report on the Financial Statements" is unnecessary in circumstances when the second subheading "Report on Other Legal and Regulatory Requirements" is not applicable.

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

also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Basis for Qualified Opinion

ABC Company's investment in XYZ Company, a foreign associate acquired during the year and accounted for by the equity method, is carried at xxx on the balance sheet as at December 31, 20X6, and ABC's share of XYZ's net income of xxx is included in ABC's income for the year then ended. We were unable to obtain sufficient appropriate audit evidence about the carrying amount of ABC's investment in XYZ as at December 31, 20X6 and ABC's share of XYZ's net income for the year because we were denied access to the financial information, management, and the auditors of XYZ. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.

Qualified Opinion

In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements give a true and fair view of (*or "present fairly, in all material respects,"*) the financial position of ABC Company as at December 31, 20X6, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Report on Other Legal and Regulatory Requirements

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

[*Auditor's signature*]

[*Date of the auditor's report*]

[*Auditor's address*]

Example Report 4: Auditor's report with a disclaimer of opinion due to the auditor's inability to obtain sufficient appropriate audit evidence about a single matter pertaining to the financial statements. The auditor is unable to obtain audit evidence about the financial information of a joint venture investment that represents over 90% of the company's net assets. The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements.

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements[7]

We were engaged to audit the accompanying financial statements of ABC Company, which comprise the balance sheet as at December 31, 20X6, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

Basis for Disclaimer of Opinion

The company's investment in its joint venture XYZ (Country X) Company is carried at xxx on the company's balance sheet, which represents over 90% of the company's net assets as at December 31, 20X6. We were not allowed access to the management and the auditors of XYZ, including XYZ's auditors' audit documentation. As a result, we were unable to determine whether any adjustments were necessary in respect of the company's proportional share of XYZ's assets that it controls jointly, its proportional share of XYZ's liabilities for which it is jointly

[7] The subheading "Report on the Financial Statements" is unnecessary in circumstances when the second subheading "Report on Other Legal and Regulatory Requirements" is not applicable.

responsible, its proportional share of XYZ's income and expenses for the year, and the elements making up the statements of changes in equity and cash flows.

Disclaimer of Opinion

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

Report on Other Legal and Regulatory Requirements

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

[*Auditor's signature*]

[*Date of the auditor's report*]

[*Auditor's address*]

Example Report 5: Auditor's report with a disclaimer of opinion due to the auditor's inability to obtain sufficient appropriate audit evidence about multiple elements in the financial statements. The auditor is 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.

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements[8]

We were engaged to audit the accompanying financial statements of ABC Company, which comprise the balance sheet as at December 31, 20X6, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

Basis for Disclaimer of Opinion

We were not appointed as auditors of the company until after December 31, 20X6 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 December 31, 20X5 and 20X6 which are stated in the balance sheet at xxx and xxx, respectively. In addition, the introduction of a new computerized accounts receivable system in September 20X6 resulted in numerous errors in accounts receivable. As of the date of our audit 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

[8] The subheading "Report on the Financial Statements" is unnecessary in circumstances when the second subheading "Report on Other Legal and Regulatory Requirements" is not applicable.

accounts receivable included in the balance sheet at a total amount of xxx as at December 31, 20X6. 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 statements of income, changes in equity and cash flows.

Disclaimer of Opinion

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

Report on Other Legal and Regulatory Requirements

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

[*Auditor's signature*]

[*Date of the auditor's report*]

[*Auditor's address*]

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