CHAPTER SIX: AUDITORS' REPORTS

6. 1. Introduction

The audit report is usually the only channel of communication between the shareholders of the company whose financial statements have been subject to audit and the auditors. As such the report acts as a bridge taking the large volume of information possessed by auditors and conveying it to the shareholders in a much abbreviated form. In order to convey information in a succinct/brief/ form the audit report has become an extremely formalized group of phrases, each of which has special significance.

6.2. THE AUDITORS' REPORT

The audit report is the document through which the auditor communicates his opinion.

- Is the end product of every audit.
- Is the medium through which the auditor expresses his opinion on the economic information under audit
- It is the only means through which the users of the information come to know of the opinion of the auditor
- The auditor may also be held liable if the report does not contain any material piece of information or is improper in any other manner

6.2.1. Types of audit opinion

The auditor's opinion as expressed in the audit report may be:

- Unqualified
- Qualified
- Disclaimer
- Adverse

All significant reasons for the issuance of a qualified, adverse, or denial of opinion should be set forth in a reservation paragraph between the scope and opinion paragraph. Auditors must qualify their report whenever there are material deficiencies in the client's financial statements.

A. Unqualified opinion

Means in the auditors' opinion the financial statements:

- Give true and fair view or present fairly the entity's affairs
- Comply with applicable reporting framework

The unqualified report is issued when the following conditions are met:

- All statements - balance sheet, income statement, statements of retained earnings, and statement of cash flows are included in the financial statement.
- The three general standards have been followed in all respects on the engagements.
- Sufficient evidence has been accumulated.
- The financial statements are presented in accordance with generally accepted accounting principles.
- Acceptable accounting policies have been used in the preparation of the financial statements
- The accounting policies used in the preparation of the financial statements have been consistent
- All material matters relevant to the proper presentation of the financial statements have been adequately disclosed.

The auditor may conclude that the financial statements fail to disclose a true and fair and an unqualified opinion cannot be expressed.

Examples of matters which may lead to such a conclusion could be:

- The financial statements do not conform to accounting principles appropriate to the circumstances and nature of the business
- The financial statements are prepared on principles inconsistent with those previously adopted and without adequate explanation of the effects of the change
- The financial do not disclose information which is necessary for the presentation of a true and fair view

An auditor may not be able to express an unqualified opinion when any of the following circumstances exist, and in the auditor's judgment, the effect of the matter is or may be fundamental to the financial statements, viz.:

- There is a limitation in the scope of the auditor's work
- The auditor disagrees with the management concerning the financial statements
- Significant uncertainty affecting the financial statements exists and the resolution of the uncertainty depends on future events.
- Inadequate disclosure

Under certain circumstances, however, auditors may add additional wording to the standard report even though they are issuing an unqualified opinion. This additional wording draws attention to certain statutory requirements or a specific matter. Another modification of a standard audit report is the auditors' emphasis of a matter regarding the client's financial statements. Emphasis of matter may require in the auditor's unqualified report (1) to highlight a matter regarding a going concern problem and (2) when there is a significant uncertainty (other than going concern problem), the resolution of which is dependent upon future events and which may affect the financial statements.

B. **Qualified opinion -except for**:

This is issued when there is a limitation of Scope; or the auditor disagrees with an accounting treatment or disclosure. The opinion states that except for the effects of some material departure/exit/ from GAAP, or some material limitation in the scope of the auditors' examination, the financial statements are presented fairly. The auditors' reports should have a separate **reservation paragraph** disclosing the reasons for the qualification.

C. **Adverse opinion:**

This is a stronger form of 'except for' opinion – the disagreement is so material that the financial statements as a whole are misreading. When the auditors express an adverse opinion, they must have accumulated sufficient appropriate evidence to support their unfavourable opinion.

Whenever the auditors issue an adverse opinion, they should disclose in a separate paragraph of their report the reasons for the adverse opinion and the principal effects of the adverse opinion on the client company's financial position and operating results.

D. **Denial of opinion. A denial (disclaimer**) of opinion is no opinion.

In an audit engagement, a denial is required when very significant restrictions on the scope of the audit preclude compliance with generally accepted auditing standards.

A very significant scope limitation may be caused by the client or by the timing of the auditors' appointment and their audit work or by factors beyond the control of the client or the auditors, rather than by restrictions imposed by the client.

Guidelines in Expressing Opinion other than Unqualified

- Before giving such a report, it would be advisable on the part of the auditor to discuss the points at issue with the client management
- In case provision of additional information or amendment to the financial statements is not possible, the auditor expresses a qualified opinion
- A clear description of the reasons which led the auditor to this action and wherever possible a quantification of the possible effects of same on the financial statements should be given
- Accordingly when an opinion other than unqualified one is called for, the auditor must decide:
  - To which specific matters his reservations apply

- Whether he actively disagrees, or on the other hand, lacks sufficient evidence to enable him to form an opinion as regards material items in the financial statements
- Whether, in the event, the matters in question are so material as to affect the presentation of a true and fair view

- A qualifying statement should be direct and informative and leave the reader in no doubt as to its meaning or view formed by the auditor or the implications for the financial statements. It should:
  - Be as brief as is consistent with clarity
  - Be specific as to the items and facts, and as far as possible, the amounts involved
  - Within the limits of information available to the auditor, make clear its effects on the accounts
  - Express the auditors opinion without giving a chance for misinterpretation
- The auditor should not refrain from making specific comments and indicate in general terms the point at issue, as a result of request from client's management on the ground that this would be harmful to them

Summary of auditors' reports

Materiality of the issue	**Type of report**
Not material	Unqualified
	Departure from GAAP → Qualified 'except for'
	scope limitation → qualified 'except for'
Material	
Very material	adverse / denial

6.2.2. Contents of Audit Report

This report contains the following important elements:

- **Title:-** Auditing standards require that the report be titled and include the word independent.

The use of 'Independent Auditor's Report' distinguishes this report from any other report.

- **Address:-**The report should be addressed to the intended users wh0ich are usually the shareholders, board of directors or other party defined in the engagement.
- **Introductory paragraph:-** The first paragraph of the report does three things
  - First, it makes the simple statement that the CPA firm has done an audit. This is intended to distinguish the report from a compilation or review report.
  - Specifies the financial statements to which the report relates,
  - Specifies the respective responsibilities of directors and auditors, and;

Statement of Responsibilities of Management

- ✓ Preparation of financial statements which show a true and fair view or present fairly the entity's affairs in accordance with the applicable financial reporting framework
- ✓ Designing and implementing an effective internal control system
- ✓ Applying appropriate accounting policies
- ✓ Making reasonable accounting estimates

Statement of Responsibilities of the Auditors

- ✓ Express opinion
- ✓ Assess the risk of material misstatement

- ✓ The fact that the audit was planned and performed to obtain reasonable assurance about whether the financial statements are free from material misstatement
- ✓ Consider internal control as a basis for preparing financial statements without responsibility for implementing it
- ✓ Obtain sufficient, appropriate audit evidence on which to base the opinio

- **Scope paragraph:-**The scope paragraph describes the **nature** of an audit. The scope paragraph states the following:
  - The standards under which the audit was conducted
    The auditors followed GAAS,
  - A summary of audit processes and procedures in general terms

  The audit is designed to obtain a reasonable assurance about whether the financial statements are free of material misstatements.
  - Evaluate the appropriateness of accounting policies
  - Evaluate the overall presentation of the financial statements

  The audit evidence accumulated and the auditor believes the evidence accumulated was appropriate for the circumstances to express the opinion presented.
- **Opinion paragraph:** The final paragraph in the standard report states the auditors' conclusion based on the results the audit examination.
- This covers the primary statements and associated notes referred to in the introductory paragraph:

A. Truth and fairness (or presented fairly in all material respects)
B. Preparation in accordance with the financial reporting framework – applicable legislation and accounting standards

Name of the audit firm/Auditor's Signature: The report may be signed by the firm, by the auditor individually or both

- **Audit report date**. The appropriate data for the audit report is the one on which the auditor has completed the most important auditing procedures in the field.
- **Auditor's Address**
- The audit report should name a specific location, which is normally the city where the auditor maintains the office that has responsibility for the audit.