

## **Modifications of Independent Auditor's Opinions and Reports**

Two key objectives of any auditor are to obtain sufficient, appropriate audit evidence to support their audit opinion, and to then report their opinion on the financial statements based on the evidence obtained.

On 16<sup>th</sup> March 2020 the FRC issued guidance to auditors on *Audit Issues Arising from the Consequences of the Covid-19 (Coronavirus) Pandemic*.<sup>1</sup> The guidance deals with practical difficulties facing companies and auditors in preparing financial statements and carrying out audits. In our guidance we highlighted the possibility that current circumstances may require auditors to consider modifying their audit opinion.

The need for a modified opinion may arise because certain audit procedures cannot be performed (for example physical inventory testing because of travel restrictions), and no other procedures can be undertaken to produce the required volume or quality of reliable audit evidence. Alternatively, management's key judgements in areas such as asset and liability valuations, or the assumptions and cashflow estimates underpinning the use of the going concern basis of accounting, may be difficult to support in the light of wider economic and political uncertainty, or not agreed by the auditor.

### **Modified Opinions**

Two primary factors contribute to the kind of modified opinion which auditors can give.<sup>2</sup> These are:

- whether the auditor has been able to obtain sufficient, appropriate audit evidence to form an opinion on whether the financial statements are free from material misstatement; and
- how pervasive any error may be to the financial statements.

As a result, audit opinions may be modified in the following ways:

### **Qualified Opinion**

Where an auditor concludes that there is either a lack of sufficient appropriate audit evidence, or actual (or potential) material misstatements in a set of financial statements, but that it is limited to a specific set of balances, transactions or disclosures, then the qualification of the auditor's opinion only applies to those items. In this case the auditor is reporting that 'other than' the specific items described, they have concluded that the financial statements are otherwise true and fair.

This is **not** the same as where an auditor is prevented by management from obtaining sufficient appropriate audit evidence (a 'limitation of scope'). Where this is the case the auditor may withdraw from an engagement, give a qualified opinion, or disclaim their opinion depending on the circumstances.

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<sup>1</sup> [https://www.frc.org.uk/news/march-2020-\(1\)/guidance-on-audit-issues-arising-from-the-covid-19](https://www.frc.org.uk/news/march-2020-(1)/guidance-on-audit-issues-arising-from-the-covid-19)

<sup>2</sup> International Standard on Auditing (UK) 705 (Revised June 2016), *Modifications to the Opinion in the Independent Auditor's Report*

## ***Adverse Opinion***

Where the auditor concludes on the basis of sufficient, appropriate evidence that material and pervasive misstatements exist that undermine the reliability of the financial statements as a whole then they give an 'adverse' opinion.

## ***Disclaimer of Opinion***

Where the auditor has not been able to obtain sufficient, appropriate audit evidence to be able to give an opinion but concludes that potential material and pervasive misstatements may exist, then they 'disclaim' their opinion entirely.

We have included a diagram at page 4 of this guidance setting out the decision-making process an auditor follows when considering a modified opinion, and the circumstances that apply in each case. This is intended to provide the users of financial statements with a better understanding of why an auditor has modified their report. This occurs where, either an auditor is unable to obtain sufficient, appropriate audit evidence (because it is no longer possible to perform relevant audit procedures or because of the inherent uncertainty about the impact on a company of the pandemic); or because they disagreed with management; and the extent to which this undermines the reliability of part, or all, of a set of financial statements.

## **Additional disclosures in the Independent Auditor's Report which are NOT modifications of the opinion**

Users of financial statements may also find additional disclosures within the auditor's report, which do not affect or change the auditor's opinion, which remains unqualified. These include:

- Key Audit Matters<sup>3</sup>

Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements. Users of financial statements should note that matters giving rise to a modified opinion are **not** included within the Key Audit Matters section of the auditor's report, but under a separate heading. Similarly, issues relating to going concern are only included within the Key Audit Matters section of the auditor's report when the auditor has concluded that management has accounted for going concern appropriately and there is no material uncertainty about the company's ability to continue as a going concern.

- An Emphasis of Matter<sup>4</sup>

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.

- Certain disclosures relating to going concern<sup>5</sup>

The auditor is required to make certain additional disclosures relating to going concern where management's accounting treatment is appropriate and:

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<sup>3</sup> ISA (UK) 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

<sup>4</sup> ISA (UK) 706, *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*

<sup>5</sup> The relevant auditing standard is ISA (UK) 570.

- (i) where no material uncertainty has been identified - reporting is by exception under the heading 'Conclusions relating to Going Concern'
- (ii) where a material uncertainty has nevertheless been identified, and this is appropriately disclosed in the financial statements – reporting is under the heading 'Material Uncertainty Related to Going Concern'

It is only where the auditor concludes that management's proposed approach to the use of the going concern basis of accounting is not appropriate, or that there is insufficient disclosure about a material uncertainty, that a modified opinion will arise.

- (i) Where the use of the going concern basis is not appropriate, the auditor gives an adverse opinion
- (ii) Where there is insufficient disclosure about a material uncertainty, the auditor gives either a qualified or adverse opinion
- (iii) Where there is insufficient evidence to support management's determination that the financial statements should be prepared on a going concern basis, the auditor disclaims their opinion

In this case, the auditor's conclusions are set out in a separate dedicated part of their report.

