

ASA 705
(March 2009)

Auditing Standard ASA 705
Modifications to the Opinion
in the Independent Auditor's
Report (Revised and
Redrafted)

Issued by the **Auditing and Assurance Standards Board**

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PREFACE

Reasons for Issuing Auditing Standard ASA 705 *Modifications to the Opinion in the Independent Auditor's Report (Revised and Redrafted)*

The Auditing and Assurance Standards Board (AUASB) issues Auditing Standard ASA 705 *Modifications to the Opinion in the Independent Auditor's Report* pursuant to the requirements of the legislative provisions and the Strategic Direction explained below.

The AUASB is an independent statutory board of the Australian Government established under section 227A of the *Australian Securities and Investments Commission Act 2001*, as amended (ASIC Act). Under section 336 of the *Corporations Act 2001*, the AUASB may make Australian Auditing Standards for the purposes of the corporations legislation. These Auditing Standards are legislative instruments under the *Legislative Instruments Act 2003*.

Under the Strategic Direction given to the AUASB by the Financial Reporting Council (FRC), the AUASB is required to have regard to any programme initiated by the IAASB for the revision and enhancement of the ISAs and to make appropriate consequential amendments to the Australian Auditing Standards. Accordingly, the AUASB has decided to revise and redraft the Australian Auditing Standards using the equivalent redrafted ISAs.

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Main Features

This Auditing Standard establishes mandatory Requirements and provides Application and Other Explanatory Material regarding the auditor's responsibility to modify the opinion on the financial report when the auditor concludes the financial report is not free of material misstatement or the auditor is unable to obtain sufficient appropriate audit evidence to conclude the financial report is free from material misstatement.

This Auditing Standard:

- (a) Defines "pervasive" in the context of modifications to the auditor's opinion.
- (b) Defines the circumstances when an auditor is required to modify the auditor's opinion.
- (c) Describes how the auditor determines the appropriate type of modification to the auditor's opinion.
- (d) Describes the form and content of the auditor's report when the opinion is modified.
- (e) Requires the auditor to communicate with those charged with governance when the auditor expects to modify the opinion in the auditor's report.

AUASB Information Note

The IAASB has announced completion of the "Clarity" project. While all currently known conforming amendments are incorporated into this Exposure Draft, readers are advised that the AUASB may decide to make further conforming amendments and other editorial changes.

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AUTHORITY STATEMENT

The Auditing and Assurance Standards Board (AUASB) makes this Auditing Standard ASA 705 *Modifications to the Opinion in the Independent Auditor's Report (Revised and Redrafted)* pursuant to section 227B of the *Australian Securities and Investments Commission Act 2001* and section 336 of the *Corporations Act 2001*.

This Auditing Standard is to be read in conjunction with ASA 101 *Preamble to Australian Auditing Standards*, which sets out the intentions of the AUASB on how the Australian Auditing Standards, operative for financial reporting periods commencing on or after 1 January 2010, are to be understood, interpreted and applied.

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Application

- Aus 0.1 This Auditing Standard applies to:
- (a) an audit of a financial report for a financial year, or an audit of a financial report for a half-year, in accordance with the *Corporations Act 2001*; and
 - (b) an audit of a financial report or a complete set of financial statements for any other purpose.
- Aus 0.2 This Auditing Standard also applies, as appropriate, to an audit of other historical financial information.

Operative Date

- Aus 0.3 This Auditing Standard is operative for financial reporting periods commencing on or after 1 January 2010.

Introduction

Scope of this ASA

1. This Auditing Standard deals with the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with ASA 700 (Revised and Redrafted),¹ the auditor concludes that a modification to the auditor's opinion on the financial report is necessary.

Types of Modified Opinions

2. This Auditing Standard 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: (Ref: Para. A1)

¹ See ASA 700 (Revised and Redrafted) *Forming an Opinion and Reporting on a Financial Report*.

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

Effective Date

3. [Deleted by the AUASB. Refer Aus 0.3]

Objective

4. The objective of the auditor is to express clearly an appropriately modified opinion on the financial report that is necessary when:
- (a) The auditor concludes, based on the audit evidence obtained, that the financial report as a whole is not free from material misstatement; or
 - (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial report as a whole is free from material misstatement.

Definitions

5. For the purposes of the Australian Auditing Standards, the following terms have the meanings attributed below:
- (a) Pervasive means a term used, in the context of misstatements, to describe the effects on the financial report of misstatements or the possible effects on the financial report of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate audit evidence. Pervasive effects on the financial report are those that, in the auditor's judgement:
 - (i) Are not confined to specific elements, accounts or items of the financial report;
 - (ii) If so confined, represent or could represent a substantial proportion of the financial report; or

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- (iii) In relation to disclosures, are fundamental to users' understanding of the financial report.
- (b) Modified opinion means a qualified opinion, an adverse opinion or a disclaimer of opinion.

Requirements

Circumstances When a Modification to the Auditor's Opinion Is Required

- 6. 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 report as a whole is not free from material misstatement; or (Ref: Para. A2-A7)
 - (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial report as a whole is free from material misstatement. (Ref: Para. A8-A12)

Determining the Type of Modification to the Auditor's Opinion

Qualified Opinion

- 7. 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 report; 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 report of undetected misstatements, if any, could be material but not pervasive.

Adverse Opinion

- 8. 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 report.

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Disclaimer of Opinion

9. 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 report of undetected misstatements, if any, could be both material and pervasive.
10. 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 report due to the potential interaction of the uncertainties and their possible cumulative effect on the financial report.

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

11. 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 report, the auditor shall request that management remove the limitation.
12. If management refuses to remove the limitation referred to in paragraph 11 of this Auditing Standard, the auditor shall communicate the matter to those charged with governance, unless all of those charged with governance are involved in managing the entity,² and determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence.
13. 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 report 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 report of undetected misstatements, if any, could

² See ASA 260 (Revised and Redrafted) *Communication with Those Charged with Governance*, paragraph 13.

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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: (Ref: Para. A13-A14)

- (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 report.

14. If the auditor withdraws as contemplated by paragraph 13(b)(i) of this Auditing Standard, 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. (Ref: Para. A15)

Other Considerations Relating to an Adverse Opinion or Disclaimer of Opinion

15. When the auditor considers it necessary to express an adverse opinion or disclaim an opinion on the financial report 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 report³ in these circumstances would contradict the auditor's adverse opinion or disclaimer of opinion on the financial report as a whole. (Ref: Para. A16)

Form and Content of the Auditor's Report When the Opinion Is Modified

Basis for Modification Paragraph

16. When the auditor modifies the opinion on the financial report, the auditor shall, in addition to the specific elements required by ASA 700 (Revised and 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

³ ASA 805 (Revised and Redrafted) *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement* deals with circumstances where the auditor is engaged to express a separate opinion on one or more specific elements, accounts or items of a financial statement.

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use the heading “Basis for Qualified Opinion,” “Basis for Adverse Opinion,” or “Basis for Disclaimer of Opinion,” as appropriate.
(Ref: Para. A17)

17. If there is a material misstatement of the financial report that relates to specific amounts in the financial report (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)
18. If there is a material misstatement of the financial report that relates to narrative disclosures, the auditor shall include in the basis for modification paragraph an explanation of how the disclosures are misstated.
19. If there is a material misstatement of the financial report 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;
- Aus 19.1 Request management and/or those charged with governance to correct the non-disclosure in the financial report;
(Ref: Para. Aus A19.1)
- (b) Describe in the basis for modification paragraph 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. (Ref: Para. A19)
- Aus 19.2 Where, under paragraph 19(c), the omitted disclosures are not included in the basis of modification paragraph, the auditor shall include the reasons for the omission from the basis of modification paragraph.
20. 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.

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21. Even if the auditor has expressed an adverse opinion or disclaimed an opinion on the financial report, the auditor shall describe in the basis for modification paragraph 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. (Ref: Para. A20)

Opinion Paragraph

22. 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. A21, A23-A24)
23. When the auditor expresses a qualified opinion due to a material misstatement in the financial report, 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:
- (a) The financial report presents fairly, in all material respects (or give a true and fair view) in accordance with the applicable financial reporting framework when reporting in accordance with a fair presentation framework; or
 - (b) The financial report has been prepared, in all material respects, in accordance with the applicable financial framework when reporting in accordance with a compliance 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. A22)

24. 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:
- (a) The financial report does not present fairly (or give a true and fair view) in accordance with the applicable financial reporting framework when reporting in accordance with a fair presentation framework; or

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- (b) The financial report has not been prepared, in all material respects, in accordance with the applicable financial reporting framework when reporting in accordance with a compliance framework.
25. 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:
- (a) 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,
 - (b) the auditor does not express an opinion on the financial report.

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

26. 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

27. 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 report. 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 report based on conducting the audit in accordance with Australian Auditing Standards. 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."

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Communication with Those Charged with Governance

28. 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 proposed wording of the modification. (Ref: Para. A25)

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Application and Other Explanatory Material

Types of Modified Opinions (Ref: Para. 2)

A1. The table below illustrates how the auditor's judgement about the nature of the matter giving rise to the modification, and the pervasiveness of its effects or possible effects on the financial report, affects the type of opinion to be expressed.

<i>Nature of Matter Giving Rise to the Modification</i>	<i>Auditor's Judgement about the Pervasiveness of the Effects or Possible Effects on the Financial Report</i>	
	<i>Material but Not Pervasive</i>	<i>Material and Pervasive</i>
Financial report is materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

Nature of Material Misstatements (Ref: Para. 6(a))

A2. ASA 700 (Revised and Redrafted) requires the auditor, in order to form an opinion on the financial report, to conclude as to whether reasonable assurance has been obtained about whether the financial report as a whole is free from material misstatement.⁴ This conclusion takes into account the auditor's evaluation of uncorrected misstatements, if any, on the financial report in accordance with ASA 450 (Revised and Redrafted).⁵

A3. ASA 450 (Revised and Redrafted) defines a misstatement as a difference between the amount, classification, presentation, or disclosure of a reported financial report item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting

⁴ See ASA 700 (Revised and Redrafted), paragraph 11.

⁵ See ASA 450 (Revised and Redrafted) *Evaluation of Misstatements Identified during the Audit*, paragraph 4(a).

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framework. Accordingly, a material misstatement of the financial report 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 report.

Appropriateness of the Selected Accounting Policies

- A4. In relation to the appropriateness of the accounting policies management has selected, material misstatements of the financial report may arise when:
- (a) The selected accounting policies are not consistent with the applicable financial reporting framework; or
 - (b) The financial statements, including the related notes, do not represent the underlying transactions and events in a manner that achieves fair presentation.
- A5. 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 report may arise when the entity has not complied with these requirements.

Application of the Selected Accounting Policies

- A6. In relation to the application of the selected accounting policies, material misstatements of the financial report may arise:
- (a) 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
 - (b) Due to the method of application of the selected accounting policies (such as an unintentional error in application).

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Appropriateness or Adequacy of Disclosures in the Financial Report

- A7. In relation to the appropriateness or adequacy of disclosures in the financial report, material misstatements of the financial report may arise when:
- (a) The financial report does not include all of the disclosures required by the applicable financial reporting framework;
 - (b) The disclosures in the financial report are not presented in accordance with the applicable financial reporting framework; or
 - (c) The financial report does not provide the disclosures necessary to achieve fair presentation.

Nature of an Inability to Obtain Sufficient Appropriate Audit Evidence
(Ref: Para. 6(b))

- A8. 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.
- A9. An inability to perform a specific procedure does not constitute a limitation on the scope of the audit if the auditor is able to obtain sufficient appropriate audit evidence by performing alternative procedures. If this is not possible, the requirements of paragraphs 7(b) and 10 apply as appropriate. Limitations imposed by management may have other implications for the audit, such as for the auditor's assessment of fraud risks and consideration of engagement continuance.
- A10. Examples of circumstances beyond the control of the entity include when:
- The entity's accounting records have been destroyed.

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- 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 an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management-Imposed Limitation after the Auditor Has Accepted the Engagement (Ref: Para. 13(b)-14)

- Aus A12.1 An inability to obtain sufficient appropriate audit evidence due to a management-imposed limitation may be a matter that the auditor is required to report to ASIC under sec. 311, sec.601HG or sec.990K of the *Corporations Act 2001* (the Act). Particular attention should be given to sec. 312 of the Act which deals with assisting an auditor.
- A13. The practicality of withdrawing from the audit may depend on the stage of completion of the engagement at the time that management imposes the scope limitation. If the auditor has substantially completed the audit, the auditor may decide to complete the audit to

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the extent possible, disclaim an opinion and explain the scope limitation in the Basis for Disclaimer of Opinion paragraph prior to withdrawing.

- A14. In certain circumstances, withdrawal from the audit may not be possible if the auditor is required by law or regulation to continue the audit engagement. This may be the case for an auditor that is appointed to audit the financial report of public sector entities. It may also be the case in jurisdictions where the auditor is appointed to audit the financial report covering a specific period, or appointed for a specific period and is prohibited from withdrawing before the completion of the audit of that financial report or before the end of that period, respectively. The auditor may also consider it necessary to include an Other Matter paragraph in the auditor's report.⁶
- A15. When the auditor concludes that withdrawal from the audit is necessary because of a scope limitation, there may be a professional, legal or regulatory requirement for the auditor to communicate matters relating to the withdrawal from the engagement to regulators or the entity's owners.
- Aus A15.1 Under the *Corporations Act 2001*, the removal and resignation of auditors is covered by sec. 329 and sec. 331AC [see also ASIC Regulatory Guide 26 *Resignation of Auditors*].

Other Considerations Relating to an Adverse Opinion or Disclaimer of Opinion (Ref: Para. 15)

- A16. The following are examples of reporting circumstances that would not contradict the auditor's adverse opinion or disclaimer of opinion:
- The expression of an unmodified opinion on a financial report prepared under a given financial reporting framework and, within the same report, the expression of an adverse opinion on the same financial report under a different financial reporting framework.⁷
 - The expression of a disclaimer of opinion regarding the results of operations, and cash flows, where relevant, and an unmodified opinion regarding the financial position (see

⁶ See ASA 706 (Revised and Redrafted) *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*, paragraph A5.

⁷ See paragraph A32 of ASA 700 (Revised and Redrafted) for a description of this circumstance.

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ASA 510 (Revised and Redrafted).⁸). In this case, the auditor has not expressed a disclaimer of opinion on the financial report as a whole.

Form and Content of the Auditor's Report When the Opinion Is Modified

Basis for Modification Paragraph (Ref: Para. 16-17, 19, 21)

- A17. Consistency in the auditor's report helps to promote 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, income before taxes, 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 disclosures have not been prepared by management or the disclosures are otherwise not readily available to the auditor; or
 - (b) In the auditor's judgement, the disclosures would be unduly voluminous in relation to the auditor's report.
- Aus A19.1 Where a material misstatement of the financial report that relates to the non-disclosure of information required to be disclosed, remains uncorrected, the auditor needs to consider reporting obligations under section 311 of the *Corporations Act 2001*.
- A20. An adverse opinion or a disclaimer of opinion relating to a specific matter described in the basis for qualification paragraph does not justify the omission of a description of other identified matters that would have otherwise required a modification of the auditor's

⁸ See ASA 510 (Revised and Redrafted) *Initial Audit Engagements—Opening Balances*, paragraph 10.

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opinion. In such cases, the disclosure of such other matters of which the auditor is aware may be relevant to users of the financial report.

Opinion Paragraph (Ref: Para. 22-23)

- A21. Inclusion of this paragraph heading makes it clear to the user that the auditor's opinion is modified and indicates the type of modification.
- A22. 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

- A23. Illustrations 1 and 2 in the Appendix contain auditors' reports with qualified and adverse opinions, respectively, as the financial report is materially misstated.
- A24. Illustration 3 in the Appendix contains an auditor's report with a qualified opinion as the auditor is unable to obtain sufficient appropriate audit evidence. Illustration 4 contains a disclaimer of opinion due to an inability to obtain sufficient appropriate audit evidence about a single element of the financial report. Illustration 5 contains a disclaimer of opinion due to an inability to obtain sufficient appropriate audit evidence about multiple elements of the financial report. In each of the latter two cases, the possible effects on the financial report of the inability are both material and pervasive.

Communication with Those Charged with Governance (Ref: Para. 28)

- A25. 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

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- (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).

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Modifications to the Opinion in the Independent Auditor's Report (Revised and Redrafted)

Conformity with International Standards on Auditing

Except as noted below, this Auditing Standard conforms with International Standard on Auditing ISA 705 *Modifications to the Opinion in the Independent Auditor's Report* (Revised and Redrafted), issued by the International Auditing and Assurance Standards Board (IAASB), an independent standard-setting board of the International Federation of Accountants (IFAC).

Paragraphs that have been added to this Auditing Standard (and do not appear in the text of the equivalent ISA) are identified with the prefix "Aus".

The main difference between this Auditing Standard and ISA 705 is:

- This Auditing Standard includes the following Requirement that is not included as a Requirement in ISA 705:
 - When the application of accounting policies required or allowed by relevant statutory and other requirements has not resulted in a fair presentation in accordance with Australian Accounting Standards:
 - (a) an unmodified opinion shall be expressed with respect to presentation in accordance with relevant statutory and other requirements; and
 - (b) a qualified or adverse opinion shall be expressed with respect to presentation in accordance with Australian Accounting Standards as appropriate. (paragraph Aus 15.1)

Compliance with this Auditing Standard enables compliance with ISA 705.

Appendix 1

(Ref: Para. 2)

Illustrations of Auditors' Reports with Modifications to the Opinion

- Illustration 1: An auditor's report containing a qualified opinion due to a material misstatement of the financial report.
- Illustration 2: An auditor's report containing an adverse opinion due to a material misstatement of the financial report.
- Illustration 3: An auditor's report containing a qualified opinion due to the auditor's inability to obtain sufficient appropriate audit evidence.
- 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 financial report.
- Illustration 5: An auditor's report containing a disclaimer of opinion due to the auditor's inability to obtain sufficient appropriate audit evidence about multiple elements of the financial report.

Example Auditor's Report
General Purpose—Qualified Opinion (material misstatement)

Illustration 1:

Circumstances include the following:

- **Audit of a general purpose financial report prepared by management of the entity in accordance with Australian Accounting Standards but *not* in accordance with the requirements of the *Corporations Act 2001*.**
- **The terms of the audit engagement reflect the description of management's responsibility for the financial report in ASA 210 (Revised and Redrafted).⁹**
- **Inventories are misstated. The misstatement is deemed to be material but not pervasive to the financial report.**
- **In addition to the audit of the financial report, the auditor has other reporting responsibilities required under local law.**

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

Report on the Financial Report¹⁰

We have audited the accompanying financial report of ABC Entity, which comprises the statement of financial position as at 30 June 20X1, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes comprising a summary of significant accounting policies and other explanatory information.

⁹ See ASA 210 *Agreeing the Terms of Audit Engagements*.

¹⁰ The sub-title "Report on the Financial Report" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

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Management's¹¹ Responsibility for the Financial Report

Management is responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards,¹² and for such internal control as management determines is necessary to enable the preparation of the financial report that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation¹³ of the financial report 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.¹⁴ An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of

¹¹ Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

¹² Where management's responsibility is to prepare a financial report that gives a true and fair view, this may read: "Management is responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards, and for such..."

¹³ In the case of footnote 12, this may read: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial report that gives a true and fair view 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."

¹⁴ 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 report, 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 report in order to design audit procedures that are appropriate in the circumstances." In the case of footnote 12, this may read: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial report that gives a true and fair view in order to design audit procedures that are appropriate in the circumstances."

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

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 entity's inventories are carried in the statement of financial position at xxx. Management has not stated the inventories at the lower of cost and net realisable value but has stated them solely at cost, which constitutes a departure from Australian Accounting Standards. The entity's records indicate that had management stated the inventories at the lower of cost and net realisable value, an amount of xxx would have been required to write the inventories down to their net realisable 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 report presents fairly, in all material respects, (or gives a true and fair view of) the financial position of ABC Entity as at 30 June, 20X1, and of its financial performance and its cash flows for the year then ended in accordance with Australian Accounting 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 Auditor's Report
General Purpose—Adverse Opinion**

Illustration 2:

Circumstances include the following:

- **Audit of a consolidated entity's general purpose financial report prepared by management of the parent in accordance with Australian Accounting Standards but *not* in accordance with the requirements of the *Corporations Act 2001*.**
- **The terms of the audit engagement reflect the description of management's responsibility for the financial report in ASA 210 (Revised and Redrafted)**
- **The financial report is materially misstated due to the non-consolidation of a subsidiary. The material misstatement is deemed to be pervasive to the financial report. The effects of the misstatement on the financial report has not been determined because it was not practicable to do so.**
- **In addition to the audit of the consolidated financial report, the auditor has other reporting responsibilities required under local law**

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

Report on the Consolidated Financial Report¹⁵

We have audited the accompanying financial report of ABC Entity, which comprises the statements of financial performance as at 30 June, 20X1, and the statements of comprehensive income, statements of changes in equity and statements of cash flows for the year then ended, and notes comprising a summary of significant accounting policies and other explanatory

¹⁵ The sub-title "Report on the Consolidated Financial Report" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

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information of the entity and the consolidated entity comprising the entity and the entities it controlled at the year's end or from time to time during the financial year.

Management's¹⁶ Responsibility for the Financial Report

Management is responsible for the preparation and fair presentation of the consolidated financial report in accordance with Australian Accounting Standards,¹⁷ and for such internal control as management determines is necessary to enable the preparation of the consolidated financial report that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the consolidated financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. Those standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation¹⁸ of the consolidated financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the

¹⁶ Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

¹⁷ Where management's responsibility is to prepare a consolidated financial report that gives a true and fair view, this may read: "Management is responsible for the preparation of the consolidated financial report that gives a true and fair view in accordance with Australian Accounting Standards, and for such..."

¹⁸ In the case of footnote 17, this may read: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the consolidated financial report that gives a true and fair view 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."

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effectiveness of the entity's internal control.¹⁹ 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 report.

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 entity has not consolidated the financial statements of subsidiary XYZ Entity it acquired during 20X1 because it has not yet been able to ascertain the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This investment is therefore accounted for on a cost basis. Under Australian Accounting Standards, the subsidiary should have been consolidated because it is controlled by the entity. Had XYZ been consolidated, many elements in the accompanying financial report would have been materially affected. The effects on the financial report of the failure to consolidate have not been determined.

Adverse Opinion

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion paragraph, the consolidated financial report does not present fairly (or does not give a true and fair view of) the financial position of ABC Entity and its subsidiaries as at 30 June, 20X1, and of their financial performance and cash flows for the year then ended in accordance with Australian Accounting 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]

¹⁹ 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 report, 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 report in order to design audit procedures that are appropriate in the circumstances." In the case of footnote 17, this may read: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial report that gives a true and fair view in order to design audit procedures that are appropriate in the circumstances."

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[Date of the auditor's report]

[Auditor's address]

Draft

Example Auditor's Report
General Purpose—Qualified Opinion (insufficient evidence)

Illustration 3:

Circumstances include the following:

- **Audit of a general purpose financial report prepared by management of the entity in accordance with Australian Accounting Standards but *not* in accordance with the requirements of the *Corporations Act 2001*.**
- **The terms of the audit engagement reflect the description of management's responsibility for the financial report in ASA 210 (Revised and Redrafted).**
- **The auditor was unable 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 report.**
- **In addition to the audit of the financial report, the auditor has other reporting responsibilities required under local law.**

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

Report on the Financial Report²⁰

We have audited the accompanying financial report of ABC Entity, which comprises the statement of financial position as at 30 June, 20X1, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes comprising a summary of significant accounting policies and other explanatory information.

²⁰ The sub-title "Report on the Financial Report" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

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Management's²¹ Responsibility for the Financial Report

Management is responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards,²² and for such internal control as management determines is necessary to enable the preparation of financial report that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation²³ of the financial report 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.²⁴ An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of

²¹ Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

²² Where management's responsibility is to prepare the financial report that gives a true and fair view, this may read: "Management is responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards, and for such..."

²³ In the case of footnote 22, this may read: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial report that gives a true and fair view 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."

²⁴ 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 report, 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 report in order to design audit procedures that are appropriate in the circumstances." In the case of footnote 22, this may read: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial report that gives a true and fair view in order to design audit procedures that are appropriate in the circumstances."

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

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 Entity's investment in XYZ Entity, a foreign associate acquired during the year and accounted for by the equity method, is carried at xxx on the statement of financial position as at 30 June, 20X1, and ABC's share of XYZ's net income of xxx is included in ABC's statement of comprehensive 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 30 June, 20X1 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 report presents fairly, in all material respects, (or gives a true and fair view of) the financial position of ABC Entity as at 30 June, 20X1, and of its financial performance and its cash flows for the year then ended in accordance with Australian Accounting 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 Auditor's Report
General Purpose—Disclaimer of Opinion (insufficient evidence: single element)

Illustration 4:

Circumstances include the following:

- **Audit of a general purpose financial report prepared by management of the entity in accordance with Australian Accounting Standards but *not* in accordance with the requirements of the *Corporations Act 2001*.**
- **The terms of the audit engagement reflect the description of management's responsibility for the financial report in ASA 210 (Revised and Redrafted)**
- **The auditor was unable to obtain sufficient appropriate audit evidence about a single element of the financial report. That is, the auditor was unable to obtain audit evidence about the financial information of a joint venture investment that represents over 90% of the entity'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 report**
- **In addition to the audit of the financial report, the auditor has other reporting responsibilities required under local law.**

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

Report on the Financial Report²⁵

We were engaged to audit the accompanying financial report of ABC Entity, which comprises the statement of financial position as at 30 June, 20X1, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes comprising a

²⁵ The sub-title "Report on the Financial Report" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

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summary of significant accounting policies and other explanatory information.

Management's²⁶ Responsibility for the Financial Report

Management is responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards,²⁷ and for such internal control as management determines is necessary to enable the preparation of the financial report that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the financial report based on conducting the audit in accordance with Australian Auditing Standards. 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 entity's investment in its joint venture XYZ (Country X) Entity is carried at xxx on the entity's statement of financial position, which represents over 90% of the entity's net assets as at 30 June, 20X1. 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 entity's proportional share of XYZ's assets that it controls jointly, its proportional share of XYZ's liabilities for which it is jointly responsible, its proportional share of XYZ's income and expenses for the year, and the elements making up the statement of changes in equity and the statement of 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 report.

²⁶ Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

²⁷ Where management's responsibility is to prepare the financial report that gives a true and fair view, this may read: "Management is responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards."

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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]

Draft

Example Auditor's Report
General Purpose—Disclaimer of Opinion (insufficient evidence: multiple elements)

Illustration 5:

Circumstances include the following:

- **Audit of a general purpose financial report prepared by management of the entity in accordance with Australian Accounting Standards.**
- **The terms of the audit engagement reflect the description of management's responsibility for the financial report in ASA 210 (Revised and Redrafted).**
- **The auditor was unable to obtain sufficient appropriate audit evidence about multiple elements of the financial report. That is, the auditor was 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 report.**
- **In addition to the audit of the financial report, the auditor has other reporting responsibilities required under local law.**

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

Report on the Financial Report²⁸

We were engaged to audit the accompanying financial report of ABC Entity, which comprises the statement of financial position as at 30 June, 20X1, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes comprising a summary of significant accounting policies and other explanatory information.

²⁸ The sub-title "Report on the Financial Report" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

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Management's²⁹ Responsibility for the Financial Report

Management is responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards,³⁰ and for such internal control as management determines is necessary to enable the preparation of the financial report that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the financial report based on conducting the audit in accordance with Australian Auditing Standards. 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 entity until after 30 June, 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 30 June, 20X0 and 20X1 which are stated in the statement of financial position at xxx and xxx, respectively. In addition, the introduction of a new computerised accounts receivable system in September 20X1 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 accounts receivable included in the statement of financial position at a total amount of xxx as at 30 June, 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 comprehensive income, statement of changes in equity and statement of 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

²⁹ Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

³⁰ Where management's responsibility is to prepare the financial report that gives a true and fair view, this may read: "Management is responsible for the preparation and presentation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards."

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appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial report.

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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