

ASA 705
(October 2009)

Explanatory Statement

ASA 705 Modifications to the Opinion in the Independent Auditor's Report

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

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Australian Government

Auditing and Assurance Standards Board

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Reasons for Issuing Auditing Standard ASA 705 Modifications to the Opinion in the Independent Auditor's Report

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 as 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 Act), the AUASB may make 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 International Auditing and Assurance Standards Board (IAASB) for the revision and enhancement of the International Standards on Auditing (ISAs) and to make appropriate consequential amendments to the Australian Auditing Standards. The IAASB has undertaken a programme to redraft, and in some cases, revise, in "clarity" format, the entire suite of ISAs. Accordingly, the AUASB has decided to revise and redraft the Australian Auditing Standards using the equivalent redrafted ISAs.

Operative Date

ASA 705 *Modifications to the Opinion in the Independent Auditor's Report* is operative for financial reporting periods commencing on or after 1 January 2010.

Purpose of Auditing Standard ASA 705 Modifications to the Opinion in the Independent Auditor's Report

The purpose of the Auditing Standard is to establish Requirements and to provide Application and Other Explanatory Material to auditors regarding their responsibility to modify the auditor's opinion on the financial report when the auditor concludes the financial report is not free from material

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misstatement or the auditor is unable to obtain sufficient appropriate audit evidence to conclude the financial report is free from material misstatement.

Main Features

The Auditing Standard:

- (a) defines the circumstances when an auditor is required to modify the auditor's opinion;
- (b) describes how the auditor determines the appropriate type of modification to the auditor's opinion;
- (c) describes the form and content of the auditor's report when the opinion is modified; and
- (d) requires the auditor to communicate with those charged with governance when the auditor expects to modify the opinion in the auditor's report.

Preamble and Overall Objectives

ASA 705 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. ASA 705 is to be read also in conjunction with ASA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards*.

Process of making Australian Auditing Standards

The AUASB's Strategic Direction, *inter alia*, provides that the AUASB develop Australian Auditing Standards that:

- have a clear public interest focus and are of the highest quality;
- use the International Standards on Auditing (ISAs) of the International Auditing and Assurance Standards Board (IAASB) as the underlying standards;
- conform with the Australian regulatory environment; and
- are capable of enforcement.

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In implementing the FRC's Strategic Direction, the AUASB has undertaken a process of revision and redrafting of the Australian Auditing Standards that has:

- updated the form, layout and content of the Australian Auditing Standards;
- addressed the legal enforceability of mandatory obligations;
- maintained clarity of the auditor's obligations;
- incorporated appropriate references to Australian laws and regulations;
- clearly identified, by use of the prefix "Aus", AUASB additions to paragraphs in the Requirements or the Application and Other Explanatory Material; and
- included other amendments as necessary.

Consultation Process prior to issuing the Auditing Standard

The AUASB has consulted publicly as part of its due process in developing the Auditing Standard. Exposure Draft ED 04/09 *Proposed Auditing Standard: Modifications to the Opinion in the Independent Auditor's Report* (Re-issuance of ASA 701), was issued on 6 March 2009 with a 30 day comment period.

As an integral part of its consultation with the public, the AUASB sought comments on specific questions including:

- the completeness and accuracy of references in the Auditing Standard to relevant laws and regulations;
- the significant costs, if any, and benefits, of compliance with any additional Requirements under the Auditing Standard; and
- whether or not there exist any matters of public interest affecting the issuance of the Auditing Standard.

Submissions were received by the AUASB and these were considered as part of the development and finalisation of the Auditing Standard.

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Regulation Impact Statement

A *Regulation Impact Statement* (RIS) has been prepared in connection with the redrafting of Australian Auditing Standards in Clarity format, including *ASA 705 Modifications to the Opinion in the Independent Auditor's Report*.

The RIS has considered both the expected benefits and expected costs of the introduction of clarified auditing standards, including comments provided by stakeholders during the redrafting process. It concluded that expected benefits to users of audit services, users of audit reports, auditors and the Australian economy in general are, on balance, likely to outweigh expected costs.

Main Differences from ASA 701 Modifications to the Auditor's Report (April 2006, as amended)

The main differences between the Auditing Standard and the Auditing Standard that it supersedes, *ASA 701 Modifications to the Auditor's Report* (April 2006, as amended), are:

1. Auditing Standard ASA 705 is written in the 'clarity' format using the equivalent International Standard on Auditing (ISA 705 *Modifications to the Opinion in the Independent Auditor's Report*) as the underlying Auditing Standard. Consequently, the format, layout, and paragraph numbering styles are different from the extant Auditing Standard.
2. The extant Auditing Standard contains additional mandatory obligations and guidance paragraphs dealing with matters that do not affect the auditor's opinion but which require an emphasis of matter paragraph in the auditor's report. These mandatory obligations and guidance are now contained in a new Auditing Standard, *ASA 706 Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*.
3. To improve clarity, certain requirements and guidance in the extant Auditing Standard have been re-written, however, the equivalent meanings have been retained.
4. Certain guidance material in the extant Auditing Standard has been elevated to Requirements.
5. The following Requirements included in the Auditing Standard are in part, or full, additional compared to the extant Auditing Standard:

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- (a) 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. (Ref: Para. 11)
- (b) 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, and determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence. (Ref: Para 12)
- (c) 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 report in these circumstances would contradict the auditor's adverse opinion or disclaimer of opinion on the financial report as a whole. (Ref: Para 15)
- (d) 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 21)
- (e) 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. (Ref: Para 26)
- (f) 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

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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." (Ref: Para 27)

6. Application and Other Explanatory Material, linked to the additional Requirements listed at 4. above is also included in the Auditing Standard.

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