

(April 2006)

Explanatory Statement

ASA 701 Modifications to the Auditor's Report

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



Australian Government

Auditing and Assurance Standards Board

Explanatory Statement

Reasons for Issuing ASA 701 *Modifications to the Auditor's Report*

The Auditing and Assurance Standards Board (AUASB) issues Auditing Standard ASA 701 *Modifications to the Auditor's Report*, due to the requirements of the legislative provisions explained below.

The *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* established the AUASB as an independent statutory body under section 227A of the *Australian Securities and Investments Commission Act 2001*, as from 1 July 2004. Under section 336 of the *Corporations Act 2001*, 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*.

Process of making Auditing Standards

Section 1455 of the *Corporations Act 2001* and *Corporations Regulation 10.5.01* gave interim legal endorsement from 1 July 2004 to the majority of Auditing Standards made by the former Auditing & Assurance Standards Board of the Australian Accounting Research Foundation. The AUASB has reviewed the Auditing Standards and has proceeded to make them as legally enforceable Auditing Standards under the *Corporations Act 2001*.

The Auditing Standards have been made also in accordance with the Financial Reporting Council's Strategic Direction to the AUASB dated 6 April 2005, pursuant to section 225 of the *ASIC Act*.

The Strategic Direction, *inter alia*, provides that the AUASB develops Auditing Standards that:

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- 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 a base;
- conform with the Australian regulatory environment; and
- are capable of enforcement.

In implementing the Strategic Direction, the AUASB has undertaken a process of thorough review and revision that has:

- addressed the enforceability of mandatory requirements;
- clarified auditors' obligations under the Auditing Standards;
- provided for sector neutrality in the Auditing Standards; and
- included other amendments as necessary.

**Purpose of Auditing Standard ASA 701
*Modifications to the Auditor's Report***

The purpose of Auditing Standard ASA 701 is to establish mandatory requirements and to provide explanatory guidance on the circumstances when the auditor's report is modified and the form and the content of the modifications to the auditor's report in those circumstances.

Auditing Standard ASA 701 is to be read in conjunction with the *Preamble to AUASB Standards*, which sets out the intentions of the AUASB on how the Auditing Standards are to be understood, interpreted and applied.

Operative Date

The Auditing Standard is operative for financial reporting periods commencing on or after 1 July 2006.

Main changes from Auditing Standard AUS 702 (May 2002) *The Audit Report on a General Purpose Financial Report*

The main differences between ASA 701 and AUS 702 are that in ASA 701:

1. The word 'shall', in the **bold-type** paragraphs, is the terminology used to describe an auditor's mandatory requirements, whereas an auditor's degree of responsibility is described in AUS 702 by the word 'should'.
2. The explanatory guidance paragraphs provide guidance and illustrative examples to assist the auditor in fulfilling the mandatory requirements, whereas in AUS 702 some obligations are implied within certain explanatory paragraphs. Accordingly, such paragraphs have been redrafted to clarify that the matter forms part of the explanatory guidance.
3. The mandatory requirements and explanatory guidance relating to modifications to the auditor's report are included in this Auditing Standard, *ASA 701 Modifications to the Auditor's Report*, whereas AUS 702 contains mandatory requirements and explanatory guidance relating to modified and unmodified auditor's reports.
4. The terms used to describe modifications to the auditor's report are:
 - an emphasis of matter paragraph;
 - a qualified opinion (referred to in AUS 702 as an "except for opinion");

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- a disclaimer of opinion (referred to in AUS 702 as an “inability to form an opinion”); or
- an adverse opinion.

In this Auditing Standard, whenever an auditor expresses an opinion that is other than unqualified, a description is included in the auditor's report in a section headed “Basis for [Qualified, Disclaimer of, Adverse,] Auditor's Opinion” whereas in AUS 702, the section in the auditor's report is referred to as the “Qualification” paragraph.

Furthermore, when an auditor expresses a qualified opinion, a disclaimer of opinion or an adverse opinion, the opinion paragraph is headed “Qualified Auditor's Opinion”, “Disclaimer of Auditor's Opinion” or “Adverse Auditor's Opinion” as applicable, whereas in AUS 702, the opinion paragraph, in such cases, is headed “Qualified Audit Opinion”.

Appendix 1 contains diagrams that illustrate the use of the new terminology in this Auditing Standard.

5. The following requirements, relating to modifications contained in AUS 702, have not been included in this Auditing Standard:
 - (a) the audit report should not, except as required by this AUS, draw attention to or emphasise any matter which has, in the auditor's opinion, been adequately dealt with in the financial report (AUS 702.31);
 - (b) there is no longer a requirement for the auditor to send a copy of the audit report to the Executive Director of the Australian Accounting Research Foundation when the auditor agrees with the inclusion of additional information in the financial report so as to ensure the financial report is not misleading (AUS 702.59); and
 - (c) AASB 110 *Events after the Balance Sheet Date*, prohibits the preparation of a financial report using a

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going concern basis when the going concern assumption is no longer appropriate (main difference between AASB 110 and the superseded AASB 1002 *Events Occurring After the Reporting Date*). Accordingly, the following basic principles and essential procedures previously contained in AUS 702.64 are no longer relevant and do not appear in this Auditing Standard:

“When it is highly improbable that an entity will continue as a going concern because of an event occurring after reporting date which provides new information that does not relate to conditions existing at reporting date, and there has been adequate disclosure of this in the financial report, in accordance with AASB 1002/AAS 8 *Events Occurring After Reporting Date*, paragraph 5.1, the audit report should include an emphasis of matter section which describes the event and refers to the note to the financial statements. The auditor should carefully consider the adequacy of the disclosure of the event in the note and the reliability of all amounts and other disclosures affected by it”.

6. In addition, this Auditing Standard does not include requirements contained in paragraphs .10, .11, .32, .43, .45, .50, .54 and .62 of AUS 702.

Consultation prior to issuing this Auditing Standard

The AUASB has consulted publicly as part of its due process in developing this Auditing Standard. Exposure Draft ED 25/05 *Proposed Auditing Standard: Modifications to the Independent Auditor's Report (Re-issuance of AUS 702) Part B* was issued on 16 November 2005 with a 45 day comment period. Submissions

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were received by the AUASB and it has considered these submissions as part of the development and finalisation of this Auditing Standard.