

SA 705*

MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT

*(Effective for all audits relating to
accounting periods beginning on or after April 1, 2011¹)*

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*Published in February, 2010 issue of the Journal.

¹ The Council of the ICAI, in partial modification of the decision taken by it at its 291st meeting held in December 2009, has decided that the effective date/applicability of three standards viz SA 700 (Revised), SA 705 and SA 706 be postponed by one year and consequently the said Standards shall now be effective/applicable for audits of financial statements for periods beginning on or after 1st April, 2012 (instead of audits of financial statements for periods beginning on or after 1st April, 2011 as was earlier decided).

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Standard on Auditing (SA) 705, “Modifications to the Opinion in the Independent Auditor’s Report” should be read in the context of the “Preface to the Standards on Quality Control, Auditing, Review, Other Assurance and Related Services²”, which sets out the authority of SAs and SA 200, “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing”³.

² Published in the July, 2007 issue of the Journal.

³ Published in the March, 2010 issue of the Journal.

Modifications to the Opinion in the Independent Auditor's Report

Introduction

Scope of this SA

1. This Standard on Auditing (SA) deals with the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with SA 700 (Revised)⁴, the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary.

Types of Modified Opinions

2. This SA 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)

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

Effective Date

3. This SA is effective for audits of financial statements for periods beginning on or after April 1, 2011.

Objective

4. The objective of the auditor is to express clearly an appropriately modified opinion on the financial statements that is necessary when:

- (a) The auditor concludes, based on the audit evidence obtained, that the financial statements as a whole are not free from material misstatement; or
- (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

Definitions

5. For purposes of the SAs, the following terms have the meanings attributed below:

- (a) Pervasive – A term used, in the context of misstatements, to describe the

⁴ SA 700 (Revised), "Forming an Opinion and Reporting on Financial Statements".

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effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate audit evidence. Pervasive effects on the financial statements are those that, in the auditor's judgment:

- (i) Are not confined to specific elements, accounts or items of the financial statements;
 - (ii) If so confined, represent or could represent a substantial proportion of the financial statements; or
 - (iii) In relation to disclosures, are fundamental to users' understanding of the financial statements.
- (b) Modified opinion – 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 statements as a whole are 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 statements as a whole are 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 statements; 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 statements of undetected misstatements, if any, could be material but not pervasive.

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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 statements.

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 statements 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 statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

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 statements, the auditor shall request that management remove the limitation.

12. If management refuses to remove the limitation referred to in paragraph 11, the auditor shall communicate the matter to those charged with governance 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 statements 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 statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate

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the gravity of the situation, the auditor shall: (Ref: Para A13-A14)

- (i) Resign from the audit, where practicable and not prohibited by law or regulation; or
- (ii) If resignation from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial statements.

14. If the auditor resigns as contemplated by paragraph 13(b)(i), before resigning, 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 statements 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 report⁵ in these circumstances would contradict the auditor's adverse opinion or disclaimer of opinion on the financial statements 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 statements, the auditor shall, in addition to the specific elements required by the SA 700 (Revised), 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 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 statements that relates to specific amounts in the financial statements (including quantitative disclosures),

⁵ SA 805, "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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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 statements 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 statements 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;
- (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)

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.

21. Even if the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements, 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 statements, 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 statements present 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 statements have been prepared, in all material respects, in

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accordance with the applicable financial reporting 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 statements do 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
- (b) The financial statements have 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 statements.

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 statements. 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 statements based on conducting the audit in accordance with Standards on Auditing issued

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by the Institute of Chartered Accountants of India. 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”.

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)

Application and Other Explanatory Material

Scope of this SA

Types of Modified Opinions (Ref: Para. 2)

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

Nature of Matter Giving Rise to the Modification	Auditor's Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements	
	Material but Not Pervasive	Material and Pervasive
Financial statements are 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. SA 700 (Revised) requires the auditor, in order to form an opinion on the financial statements, to conclude as to whether reasonable assurance has been obtained about whether the financial statements as a whole are free from

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material misstatement⁶. This conclusion takes into account the auditor's evaluation of uncorrected misstatements, if any, on the financial statements in accordance with SA 450⁷.

A3. SA 450 defines a misstatement as a difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Accordingly, a material misstatement of the financial statements 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 statements.

Appropriateness of the Selected Accounting Policies

A4. In relation to the appropriateness of the accounting policies management has selected, material misstatements of the financial statements 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 statements 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 statements 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

⁶ SA 700 (Revised), paragraph 11.

⁷ SA 450, "Evaluation of Misstatements Identified during the Audit", paragraph 4(a).

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- (b) Due to the method of application of the selected accounting policies (such as an unintentional error in application).

Appropriateness or Adequacy of Disclosures in the Financial Statements

A7. In relation to the appropriateness or adequacy of disclosures in the financial statements, material misstatements of the financial statements may arise when:

- (a) The financial statements do not include all of the disclosures required by the applicable financial reporting framework;
- (b) The disclosures in the financial statements are not presented in accordance with the applicable financial reporting framework; or
- (c) The financial statements do 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.
- 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

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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)

A13. The practicability of resigning from the audit may depend upon 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 the extent possible, disclaim an opinion and explain the scope limitation in the Basis for Disclaimer of Opinion paragraph prior to resigning.

A14. In certain circumstances, resignation 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 appointed to audit the financial statements of public sector entities. It may also be the case of entities where the auditor is appointed to audit the financial statements covering a specific period, or appointed for a specific period and is prohibited from resigning before the completion of the audit of those financial statements 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 report⁸.

A15. When the auditor concludes that resignation from the audit is necessary because of a scope limitation, there may be a professional, regulatory or legal requirement for the auditor to communicate matters relating to the resignation

⁸ SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report", paragraph A5.

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from the engagement to regulators or the entity's owners.

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 financial statements prepared under a given financial reporting framework and, within the same report, the expression of an adverse opinion on the same financial statements under a different financial reporting framework⁹.
- 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 SA 510¹⁰). In this case, the auditor has not expressed a disclaimer of opinion on the financial statements 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(b), 21)

A17. Consistency in the auditor's report helps to promote the 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. Whenever the auditor expresses an opinion that is other than unqualified, a clear description of all the substantive reasons should be included in the report and, unless impracticable, a quantification of the possible effect(s), individually and in aggregate, on the financial statements should be mentioned in the auditor's report. In circumstances where it is not practicable to quantify the effect of modifications made in the audit report accurately, the auditor may do so on the basis of estimates made by the management after carrying out such audit tests as are possible and clearly indicate the fact that the figures are based on management estimates. Ordinarily, this information would be set out in a separate paragraph preceding the opinion or disclaimer of opinion and may include a reference to a more extensive discussion, if any, in a note to the

⁹ See paragraph A31 of SA 700 (Revised) for a description of this circumstance.

¹⁰ SA 510, "Initial Audit Engagements – Opening Balances", paragraph 10.

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financial statements. 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, profit before taxes, net profit and reserves 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 judgment, the disclosures would be unduly voluminous in relation to the auditor's report.

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

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 statements are 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 statements. Illustration 5 contains a disclaimer of opinion due to an inability to obtain sufficient appropriate audit evidence about multiple elements of the financial statements. In each of the latter two cases, the possible effects on the financial statements of the inability are both material and pervasive.

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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
- (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).

Material Modifications vis-a-vis ISA 705, "Modifications to the Opinion in the Independent Auditor's Report"

Additions

Paragraph 17 and A18 of ISA 705 requires the auditor to include in the basis for modification paragraph, a description and quantification of the financial effect of the misstatement. Since the said paragraph covers only the effect of the individual quantification of the misstatement on the financial statements, the paragraph A18 has been changed also to include the effect of the aggregate quantifications of the misstatements on the financial statements.

Illustrative Formats of Auditors' Reports with Modifications to the Opinion

Illustration 1

Circumstances include the following:

- Audit of a complete set of separate general purpose financial statements of a company prepared under the Companies Act, 1956 financial reporting framework.
- The terms of the audit engagement reflect description of management's responsibility for the financial statements in SA 210.
- Inventories are misstated. The misstatement is deemed to be material but not pervasive to the financial statements. The audit opinion is qualified for the misstatement.
- In addition to the audit of financial statements, the auditor has other reporting responsibilities required under the Companies Act, 1956 and/or other regulatory requirements.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company Limited

Report on the Financial Statements

We have audited the accompanying financial statements of ABC Company Limited ("the Company"), which comprise the Balance Sheet as at March 31, 20XX, and the Statement of Profit and Loss and Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation of these financial statements that give a true and fair view of the financial position, financial performance and cash flows of the Company in accordance with the Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act"). This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of the financial

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statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements 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 control¹¹. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of the accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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*¹²

The Company's inventories are carried in the Balance Sheet at Rs. 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 the Accounting Standards referred to in sub-section (3C) of section 211 of the Act. The Company's records indicate that had management stated the inventories at the lower of cost and net realisable value, an amount of Rs. XXX would have been required to write the inventories down to their net realisable

¹¹ The underlined text has been added pursuant to decision of Council of ICAI taken at its 329th adjourned meeting held in January 2014. The complete text of the Announcement in this regard has been published in Paragraph 'C', "Announcements/Clarifications" of Section 1, "Announcements of the Council regarding Status of Various Documents issued by the Institute of Chartered Accountants of India", included in Volume I.A of the Handbook.

¹² "Basis for Qualified Opinion" and "Qualified Opinion" paragraphs are in italics as required under Sec. 227(3)(e) of the Companies Act.

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value. Accordingly, cost of sales would have been increased by Rs. XXX, and income tax, net profit and shareholders' funds would have been reduced by Rs. XXX, Rs. XXX and Rs. XXX, respectively.

Qualified Opinion

In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India:

- (a) in the case of the Balance Sheet, of the state of affairs of the Company as at March 31, 20XX;
- (b) in the case of the Profit and Loss Account, of the profit/ loss for the year ended on that date; and
- (c) in the case of the Cash Flow Statement, of the cash flows for the year ended on that date.

Report on Other Legal and Regulatory Requirements

1. As required by the Companies (Auditor's Report) Order, 2003 ("the Order") issued by the Central Government of India in terms of sub-section (4A) of section 227 of the Act, we give in the Annexure a statement on the matters specified in paragraphs 4 and 5 of the Order.
2. As required by section 227(3) of the Act, we report that:
 - a. We have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit;
 - b. In our opinion proper books of account as required by law have been kept by the Company so far as appears from our examination of those books [and proper returns adequate for the purposes of our audit have been received from branches not visited by us]¹³;
 - c. the report on the accounts of the branch offices audited under section 228 by a person other than the company's auditor has been forwarded to us as required by clause (c) of sub-section (3) of section 228 and have been dealt with in preparing our report in the manner considered necessary by us¹⁴.

¹³ To be included if relevant.

¹⁴ The underlined text has been added pursuant to decision of Council of ICAI taken at its 329th adjourned meeting held in January 2014. The complete text of the Announcement in this regard has been published in Paragraph 'C', "Announcements/Clarifications" of Section 1, "Announcements of the Council regarding Status of Various Documents issued by the Institute of Chartered Accountants of India", included in Volume I.A of the Handbook.

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- d. The Balance Sheet, Statement of Profit and Loss and Cash Flow Statement dealt with by this Report are in agreement with the books of account [and with the returns received from branches not visited by us]¹⁵;
- e. Except for the effects of the matter described in the Basis for Qualified Opinion paragraph, in our opinion, the Balance Sheet, Statement of Profit and Loss and Cash Flow Statement comply with the accounting standards referred to in sub-section (3C) of section 211 of the Act;
- f. On the basis of written representations received from the directors as on March 31, 20XX, and taken on record by the Board of Directors, none of the directors is disqualified as on March 31, 20XX, from being appointed as a director in terms of clause (g) of sub-section (1) of section 274 of the Act.
- g. Since the Central Government has not issued any notification as to the rate at which the cess is to be paid under section 441A of the Companies Act, 1956 nor has it issued any Rules under the said section, prescribing the manner in which such cess is to be paid, no cess is due and payable by the Company.¹⁶

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Audit Report)
(Designation¹⁷)
Membership Number

Place of Signature
Date

¹⁵ To be included if relevant.

¹⁶ Attention of the readers is invited to the Announcement issued by the Council of the ICAI (pursuant to a decision taken in this regard at its 312th meeting held in December, 2011) regarding the auditor's reporting responsibilities pursuant to clause 4(ix)(a) of the Companies (Auditor's Report) Order, 2003 and section 227(3)(g) of the Companies Act, 1956 wrt the cess payable under Section 441A of the Companies Act, 1956. Pursuant to the said Announcement since the operative date of section 227 (3)(g) has not yet been notified by the Central Government, the statutory auditor's report need not contain any comment on section 227 (3)(g) of the Companies Act, 1956. The complete text of the Announcement is published in Paragraph 'C', "Announcements/Clarifications" of Section 1, "Announcements of the Council regarding Status of Various Documents issued by the Institute of Chartered Accountants of India", included in Volume I.A of the Handbook.

¹⁷ Partner or Proprietor, as the case may be.

Illustration 2:

Circumstances include the following:

- Audit of a complete set of consolidated general purpose financial statements of a parent company prepared under accounting principles generally accepted in India (as required for compliance with SEBI's regulatory requirement).
- The terms of the group audit engagement reflect description of management's responsibility for the financial statements in SA 210.
- The financial statements are materially misstated due to the non-consolidation of a subsidiary. The material misstatement is deemed to be pervasive to the financial statements. The effects of the misstatement on the financial statements have not been determined because it was not practicable to do so. An adverse audit opinion is given under the circumstances.

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of ABC Company Limited

We¹⁸ have audited the accompanying consolidated financial statements of ABC Company Limited ("the Company") and its subsidiaries, which comprise the consolidated Balance Sheet as at March 31, 20XX, and the consolidated Statement of Profit and Loss and consolidated Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation of these consolidated financial statements that give a true and fair view of the consolidated financial position, consolidated financial performance and consolidated cash flows of the Company in accordance with accounting principles generally accepted in India. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the consolidated financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

¹⁸ As there is no reporting on "Other Legal Requirements", there is no necessity of including the heading "Report on the Financial Statements" above the introductory paragraph.

Modifications to the Opinion in the Independent Auditor's Report

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and presentation of the consolidated financial statements that give 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 control¹⁹. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of the accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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 Company has not consolidated the financial statements of subsidiary XYZ Company it acquired during 20XX 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 acquisition is therefore accounted for as an investment. Under the accounting principles generally accepted in India, the subsidiary should have been consolidated because it is controlled by the Company. Had XYZ been consolidated, many elements in the accompanying financial statements would have been materially affected. The effects on the financial statements of the failure to consolidate have not been determined.

¹⁹ The underlined text has been added pursuant to decision of Council of ICAI taken at its 329th adjourned meeting held in January 2014. The complete text of the Announcement in this regard has been published in Paragraph 'C', "Announcements/Clarifications" of Section 1, "Announcements of the Council regarding Status of Various Documents issued by the Institute of Chartered Accountants of India", included in Volume I.A of the Handbook.

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Adverse Opinion

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion paragraph, the consolidated financial statements do not give a true and fair view in conformity with the accounting principles generally accepted in India:

- (a) in the case of the consolidated Balance Sheet, of the state of affairs of the Company as at March 31, 20XX;
- (b) in the case of the consolidated Profit and Loss Account, of the profit/ loss for the year ended on that date; and
- (c) in the case of the consolidated Cash Flow Statement, of the cash flows for the year ended on that date.

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Audit Report)
(Designation²⁰)
Membership Number

Place of Signature

Date

²⁰ Partner or Proprietor, as the case may be.

Modifications to the Opinion in the Independent Auditor's Report

Illustration 3:

Circumstances include the following:

- Audit of a complete set of separate general purpose financial statements of a company prepared under the Companies Act, 1956 financial reporting framework.
- The terms of the audit engagement reflect description of management's responsibility for the financial statements in SA 210.
- 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 statement. The audit opinion is qualified for the misstatement.
- In addition to the audit of financial statements, the auditor has other reporting responsibilities required under the Companies Act, 1956 and/or other regulatory requirements.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company Limited

Report on the Financial Statements

We have audited the accompanying financial statements of ABC Company Limited ("the Company"), which comprise the Balance Sheet as at March 31, 20XX, and the Statement of Profit and Loss and Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation of these financial statements that give a true and fair view of the financial position, financial performance and cash flows of the Company in accordance with the accounting standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act"). This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the financial statements that give a true and fair view and are free from material misstatement, whether due to fraud or error.

Handbook of Auditing Pronouncements-I.A

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements 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 control²¹. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of the accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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 Company Limited's investment in XYZ Company, a foreign associate acquired during the year and accounted for by the equity method, is carried at Rs. XXX in the Balance Sheet as at March 31, 20XX, and ABC's share of XYZ Company's net income of Rs. XXX is included in ABC Company Limited's income for the year then ended. We were unable to obtain sufficient appropriate audit evidence about the carrying amount of ABC Company Limited's investment in XYZ Company as at March 31, 20XX and ABC Company Limited's share of XYZ Company's net income for the year because we were denied access to the financial information, management, and the auditors of XYZ Company. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.

²¹ The underlined text has been added pursuant to decision of Council of ICAI taken at its 329th adjourned meeting held in January 2014. The complete text of the Announcement in this regard has been published in Paragraph 'C', "Announcements/Clarifications" of Section 1, "Announcements of the Council regarding Status of Various Documents issued by the Institute of Chartered Accountants of India", included in Volume I.A of the Handbook.

Modifications to the Opinion in the Independent Auditor's Report

Qualified Opinion

In our opinion and to the best of our information and according to the explanations given to us, except for the possible effects²² of the matter described in the Basis for Qualified Opinion paragraph, the financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India:

- (a) in the case of the Balance Sheet, of the state of affairs of the Company as at March 31, 20XX;
- (b) in the case of the Profit and Loss Account, of the profit/ loss for the year ended on that date; and
- (c) in the case of the Cash Flow Statement, of the cash flows for the year ended on that date.

Report on Other Legal and Regulatory Requirements

1. As required by the Companies (Auditor's Report) Order, 2003 ("the Order") issued by the Central Government of India in terms of sub-section (4A) of section 227 of the Act, we give in the Annexure a statement on the matters specified in paragraphs 4 and 5 of the Order.
2. As required by section 227(3) of the Companies Act, 1956, we report that:
 - a. we have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit except for the matter described in the Basis for Qualified Opinion paragraph;
 - b. in our opinion proper books of account as required by law have been kept by the Company so far as appears from our examination of those books [and proper returns adequate for the purposes of our audit have been received from branches not visited by us]²³;
 - c. the report on the accounts of the branch offices audited under section 228 by a person other than the company's auditor has been forwarded to us as required by clause (c) of sub-section (3) of section 228 and

²² Note the use of words "possible effects" as the auditor was unable to obtain sufficient appropriate audit evidence.

²³ To be included if relevant.

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have been dealt with in preparing our report in the manner considered necessary by us²⁴:

- d. the Balance Sheet, Statement of Profit and Loss and Cash Flow Statement dealt with by this Report are in agreement with the books of account [and with the returns received from branches not visited by us]²⁵;
- e. except for the possible effects²⁶ of the matter described in the Basis for Qualified Opinion paragraph, in our opinion, the Balance Sheet, Statement of Profit and Loss and Cash Flow Statement comply with the accounting standards referred to in sub-section (3C) of section 211 of the Act;
- f. on the basis of written representations received from the directors as on March 31, 20XX, and taken on record by the Board of Directors, none of the directors is disqualified as on March 31, 20XX, from being appointed as a director in terms of clause (g) of sub-section (1) of section 274 of the Act.
- g. Since the Central Government has not issued any notification as to the rate at which the cess is to be paid under section 441A of the Companies Act, 1956 nor has it issued any Rules under the said section, prescribing the manner in which such cess is to be paid, no cess is due and payable by the Company.²⁷

²⁴ The underlined text has been added pursuant to decision of Council of ICAI taken at its 329th adjourned meeting held in January 2014. The complete text of the Announcement in this regard has been published in Paragraph 'C', "Announcements/Clarifications" of Section 1, "Announcements of the Council regarding Status of Various Documents issued by the Institute of Chartered Accountants of India", included in Volume I.A of the Handbook.

²⁵ To be included if relevant.

²⁶ Note the use of words "possible effects" as the auditor was unable to obtain sufficient appropriate audit evidence.

²⁷ Attention of the readers is invited to the Announcement issued by the Council of the ICAI (pursuant to a decision taken in this regard at its 312th meeting held in December, 2011) regarding the auditor's reporting responsibilities pursuant to clause 4(ix)(a) of the Companies (Auditor's Report) Order, 2003 and section 227(3)(g) of the Companies Act, 1956 wrt the cess payable under Section 441A of the Companies Act, 1956. Pursuant to the said Announcement since the operative date of section 227 (3)(g) has not yet been notified by the Central Government, the statutory auditor's report need not contain any comment on section 227 (3)(g) of the Companies Act, 1956. The complete text of the Announcement is published in Paragraph 'C', "Announcements/Clarifications" of Section 1, "Announcements of the Council regarding Status of Various Documents issued by the Institute of Chartered Accountants of India", included in Volume I.A of the Handbook.

Modifications to the Opinion in the Independent Auditor's Report

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Audit Report)
(Designation²⁸)
Membership Number

Place of Signature

Date

²⁸ Partner or Proprietor, as the case may be.

Illustration 4:

Circumstances include the following:

- Audit of a complete set of separate general purpose financial statements of a company prepared under the Companies Act, 1956 financial reporting framework.
- The terms of the audit engagement reflect description of management's responsibility for the financial statements in SA 210.
- The auditor was unable to obtain sufficient appropriate audit evidence about a single element of the financial statements. 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 Company'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 statements. A disclaimer of audit opinion is given in the circumstances.
- In addition to the audit of financial statements, the auditor has other reporting responsibilities required under the Companies Act, 1956 and/or other regulatory requirements.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company Limited

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of ABC Company Limited ("the Company"), which comprise the Balance Sheet as at March 31, 20XX, and the Statement of Profit and Loss and the Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation of these financial statements that give a true and fair view of the financial position, financial performance and cash flows of the Company in accordance with the accounting standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act"). This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error.

Modifications to the Opinion in the Independent Auditor's Report

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India. 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 Company's investment in its joint venture XYZ Company is carried at Rs. XXX in the Company's Balance Sheet, which represents over 90% of the Company's net assets as at March 31, 20XX. We were not allowed access to the management and the auditors of XYZ Company. As a result, we were unable to determine whether any adjustments were necessary in respect of the Company's proportional share of XYZ Company's assets that it controls jointly, its proportional share of XYZ Company's liabilities for which it is jointly responsible, its proportional share of XYZ Company's income and expenses for the year, and the elements making up the Cash Flow Statement.

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 statements.

Report on Other Legal and Regulatory Requirements

1. As required by the Companies (Auditor's Report) Order, 2003 ("the Order") issued by the Central Government of India in terms of sub-section (4A) of section 227 of the Act, we give in the Annexure a statement on the matters specified in paragraphs 4 and 5 of the Order.
2. As required by section 227(3) of the Companies Act, 1956, we report that:
 - a. As described in the Basis for Disclaimer of Opinion paragraph, we were unable to obtain all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit;
 - b. Due to the possible effects²⁹ of the matter described in the Basis for Disclaimer of Opinion paragraph, we are unable to state whether proper books of account as required by law have been kept by the Company so far as appears from our examination of those books [and proper

²⁹ Note the use of words "possible effects" as the auditor was unable to obtain sufficient appropriate audit evidence.

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returns adequate for the purposes of our audit have been received from branches not visited by us]³⁰;

- c. the report on the accounts of the branch offices audited under section 228 by a person other than the company's auditor has been forwarded to us as required by clause (c) of sub-section (3) of section 228 and have been dealt with in preparing our report in the manner considered necessary by us³¹;
- d. The Balance Sheet, Statement of Profit and Loss and Cash Flow Statement dealt with by this Report are in agreement with the books of account [and with the returns received from branches not visited by us]³²;
- e. Due to the possible effects of the matter described in the Basis for Disclaimer of Opinion paragraph, we are unable to state whether the Balance Sheet, Statement of Profit and Loss and Cash Flow Statement comply with the accounting standards referred to in sub-section (3C) of section 211 of the Act;
- f. On the basis of written representations received from the directors as on March 31, 20XX, and taken on record by the Board of Directors, none of the directors is disqualified as on March 31, 20XX, from being appointed as a director in terms of clause (g) of sub-section (1) of section 274 of the Act.
- g. Since the Central Government has not issued any notification as to the rate at which the cess is to be paid under section 441A of the Companies Act, 1956 nor has it issued any Rules under the said section, prescribing the manner in which such cess is to be paid, no cess is due and payable by the Company.³³

³⁰ To be included if relevant.

³¹ The underlined text has been added pursuant to decision of Council of ICAI taken at its 329th adjourned meeting held in January 2014. The complete text of the Announcement in this regard has been published in Paragraph 'C', "Announcements/Clarifications" of Section 1, "Announcements of the Council regarding Status of Various Documents issued by the Institute of Chartered Accountants of India", included in Volume I.A of the Handbook.

³² To be included if relevant.

³³ Attention of the readers is invited to the Announcement issued by the Council of the ICAI (pursuant to a decision taken in this regard at its 312th meeting held in December, 2011) regarding the auditor's reporting responsibilities pursuant to clause 4(ix)(a) of the Companies (Auditor's Report) Order, 2003 and section 227(3)(g) of the Companies Act, 1956 wrt the cess payable under Section 441A of the Companies Act, 1956. Pursuant to the said Announcement since the operative date of section 227 (3)(g) has not yet been notified by the Central Government, the statutory auditor's report need not contain any comment on section 227 (3)(g) of the Companies Act, 1956. The complete text of the Announcement is published in Paragraph 'C', "Announcements/Clarifications" of Section 1, "Announcements of the Council regarding Status of

Modifications to the Opinion in the Independent Auditor's Report

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Audit Report)
(Designation³⁴)
Membership Number

Place of Signature

Date

Various Documents issued by the Institute of Chartered Accountants of India", included in Volume I.A of the Handbook.

³⁴ Partner or Proprietor, as the case may be.

Illustration 5:

Circumstances include the following:

- Audit of a complete set of separate general purpose financial statements of a company prepared under the Companies Act, 1956 financial reporting framework.
- The terms of the audit engagement reflect description of management's responsibility for the financial statements in SA 210.
- The auditor was unable to obtain sufficient appropriate audit evidence about multiple elements of the financial statements. 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 statements. A disclaimer of audit opinion is given in the circumstances.
- In addition to the audit of financial statements, the auditor has other reporting responsibilities required under the Companies Act, 1956 and/or other regulatory requirements.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company Limited

Report on the Financial Statements

We have audited the accompanying financial statements of ABC Company Limited ("the Company"), which comprise the Balance Sheet as at March 31, 20XX, and the Statement of Profit and Loss and Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation of these financial statements that give a true and fair view of the financial position, financial performance and cash flows of the Company in accordance with the accounting standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956 ("the Act"). This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error.

Modifications to the Opinion in the Independent Auditor's Report

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India. 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 appointed as auditors of the Company after March 31, 20XX and thus could not observe the counting of physical inventories at the beginning and end of the year. Accordingly, we were unable to satisfy ourselves by alternative means concerning the inventory quantities held at December 31, 20X0 and March 31, 20X1 which are stated in the Balance Sheet at Rs. XXX and Rs. 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 Balance Sheet at a total amount of Rs. XXX as at March 31, 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 Profit and Loss and Cash Flow Statement.

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

Report on Other Legal and Regulatory Requirements

1. As required by the Companies (Auditor's Report) Order, 2003 ("the Order") issued by the Central Government of India in terms of sub-section (4A) of section 227 of the Act, we give in the Annexure a statement on the matters specified in paragraphs 4 and 5 of the Order.
2. As required by section 227(3) of the Companies Act, 1956, we report that:

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- a. As described in the Basis for Disclaimer of Opinion paragraph, we were unable to obtain all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit;
- b. Due to the possible effects³⁵ of the matter described in the Basis for Disclaimer of Opinion paragraph, we are unable to state whether proper books of account as required by law have been kept by the Company so far as appears from our examination of those books [and proper returns adequate for the purposes of our audit have been received from branches not visited by us]³⁶;
- c. the report on the accounts of the branch offices audited under section 228 by a person other than the company's auditor has been forwarded to us as required by clause (c) of sub-section (3) of section 228 and have been dealt with in preparing our report in the manner considered necessary by us³⁷;
- d. The Balance Sheet, Statement of Profit and Loss and Cash Flow Statement dealt with by this Report are in agreement with the books of account [and with the returns received from branches not visited by us]³⁸;
- e. Due to the possible effects of the matter described in the Basis for Disclaimer of Opinion paragraph, we are unable to state whether the Balance Sheet, Statement of Profit and Loss and Cash Flow Statement comply with the accounting standards referred to in sub-section (3C) of section 211 of the Act;
- f. On the basis of written representations received from the directors as on March 31, 20X1, and taken on record by the Board of Directors, none of the directors is disqualified as on March 31, 20X1, from being appointed as a director in terms of clause (g) of sub-section (1) of section 274 of the Act.
- g. Since the Central Government has not issued any notification as to the rate at which the cess is to be paid under section 441A of the Companies Act, 1956 nor has it issued any Rules under the said section, prescribing the

³⁵ Note the use of words "possible effects" as the auditor was unable to obtain sufficient appropriate audit evidence.

³⁶ To be included if relevant.

³⁷ The underlined text has been added pursuant to decision of Council of ICAI taken at its 329th adjourned meeting held in January 2014. The complete text of the Announcement in this regard has been published in Paragraph 'C', "Announcements/Clarifications" of Section 1, "Announcements of the Council regarding Status of Various Documents issued by the Institute of Chartered Accountants of India", included in Volume I.A of the Handbook.

³⁸ To be included if relevant.

Modifications to the Opinion in the Independent Auditor's Report

manner in which such cess is to be paid, no cess is due and payable by the Company.³⁹

For XYZ and Co.
Chartered Accountants
Firm's Registration Number

Signature
(Name of the Member Signing the Audit Report)
(Designation⁴⁰)
Membership Number

Place of Signature

Date

³⁹ Attention of the readers is invited to the Announcement issued by the Council of the ICAI (pursuant to a decision taken in this regard at its 312th meeting held in December, 2011) regarding the auditor's reporting responsibilities pursuant to clause 4(ix)(a) of the Companies (Auditor's Report) Order, 2003 and section 227(3)(g) of the Companies Act, 1956 wrt the cess payable under Section 441A of the Companies Act, 1956. Pursuant to the said Announcement since the operative date of section 227 (3)(g) has not yet been notified by the Central Government, the statutory auditor's report need not contain any comment on section 227 (3)(g) of the Companies Act, 1956. The complete text of the Announcement is published in Paragraph 'C', "Announcements/Clarifications" of Section 1, "Announcements of the Council regarding Status of Various Documents issued by the Institute of Chartered Accountants of India", included in Volume I.A of the Handbook.

⁴⁰ Partner or Proprietor, as the case may be.

