Implementation Guide on Reporting Standards

(SA 700, SA 705 & SA 706)

The Institute of Chartered Accountants of India

(Set up by an Act of Parliament)

New Delhi

IMPLEMENTATION GUIDE ON REPORTING STANDARDS (SA 700, SA 705 & SA 706)

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Edition	:	November, 2010
Committee/Department	:	Auditing and Assurance Standards Board
E-mail	:	aasb@icai.org
Website	:	www.icai.org
Price	:	Rs.150/- *(including CD)*
ISBN	:	978-81-8441-407-3
Published by	:	The Publication Department on behalf of the Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi - 110 002.
Printed by	:	Sahitya Bhawan Publications, Hospital Road, Agra 282 003 November/2010/1,000 Copies

Foreword

Standards on Auditing are an important instrument in bridging the expectation gap. On the one hand they codify the best practices in the area of audit and thereby help the auditors enhance the value added by an independent audit. On the other hand, they are the performance benchmarks against which the performance of the auditors is measured by the stakeholders in the financial reporting process. It is therefore necessary that the auditors properly understand and implement these Standards in their audit engagements.

Implementation Guides to Standards are an important tool in the hands of the practitioners to appropriately understand the exacting requirements of these Standards and help them implement the Standards in an appropriate manner to meet the objectives which they are designed to achieve.

This Implementation Guide on Reporting Standards being brought out by the Auditing and Assurance Standards Board is, I feel, a benchmark publication. This Implementation Guide, written by a senior member of the profession, contains comprehensive guidance on the reporting Standards, *viz*., SA 700, SA 705 and SA 706. I am sure the Implementation Guide would be able to address the apprehensions, concerns and difficulties, if any, being faced by the practitioners in relation to these Standards and help them issue more meaningful and value add audit reports on the financial statements.

At this juncture, I may also mention that the mission of convergence with the International Standards on Auditing having been achieved early this year, our focus now is on taking these Standards to the common practitioners through various proactive awareness initiatives such as conferences/ seminars, training workshops, technical publications, etc for the benefit of the common practitioners.

I complement CA. Abhijit Bandyopadhyay, Chairman, Auditing and Assurance Standards Board who has been vigorously driving these awareness initiatives. I also keenly look forward to more such Implementation Guides and other technical publications from the Auditing and Assurance Standards Board.

November 16, 2010 CA. AMARJIT CHOPRA

New Delhi *President, ICAI*

Preface

Importance of credible financial reporting to the economic activity of a nation cannot be exaggerated. It is the independent auditor's report that lends this credibility to the financial statements which are then relied upon by the various stakeholders in the financial reporting process, be it the creditors, the investors, the regulators or the government agencies and all others who have various interests in the state of affairs of the entity.

To enable the audit reports to serve a meaningful purpose to the users of the financial statements, it is essential that they convey the auditor's opinion on the financial statements in a clear and unambiguous manner. Uniformity and comparability in their format and contents are also elements essential to enhance the usability and value of the audit reports to the users.

In 2010, the Institute of Chartered Accountants of India, issued three separate Standards on Auditing (SA) to deal with the form and content of an independent auditor's report as also the various types of opinions and special other paragraphs that may be included in the auditors report. These Standards are, SA 700, *Forming an Opinion and Reporting on Financial Statements;* SA 705, *Modifications to the Opinion in the Independent Auditor's Report;* and SA 706, Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report or "the Reporting Standards" as they are collectively called. All the three Standards are quite comprehensive and benchmarked with the corresponding International Standards on Auditing issued by the International Auditing and Assurance Standards Board and are a part of the 36 revised/ new Standards on Auditing issued by ICAI under the Clarity Project.

In line with the focus of the Auditing and Assurance Standards Board on creating awareness among the practitioners about the

Standards on Auditing issued under the Clarity Project, the Board has brought out this implementation guide to help practitioners appropriately understand the requirements of these Reporting Standards and their implementation in various actual audit scenarios.

For ease of usage and understanding of the readers, the Implementation Guide is in a “Question – Answer”. This also ensures quick referencing and avoidance of lengthy essay-type text. The Implementation Guide addresses all the major concerns of the auditor regarding reporting. The Implementation Guide consists of five chapters namely Scope of the Guide, Importance of Independent Auditor’s Report, and the next three chapters cover the three important reporting standards namely SA 700, SA 705 and 706 dealing with how to form an audit opinion, reach audit conclusions and issue different types of auditor’s reports.

The Appendix to the Guide also contains a number of useful illustrative scenarios wherein the auditor would be required to give different types of modified opinions, *viz.*, qualified/ adverse/ disclaimer of opinion.

At this juncture, I wish to express my deep gratitude to CA. Khurshed Pastakia, Mumbai who spared time out of his pressing professional and personal engagements to write this Implementation Guide in a demanding timeframe. I also wish to place on record my gratitude to CA. Amarjit Chopra, President, ICAI and CA. G Ramaswamy, Vice President, ICAI for their constant encouragement, guidance and support to the activities of the Board. I am also thankful to all my Council colleagues as well as the co-opted members and the special invitees on the Board for their valuable suggestions in making the Implementation Guide more useful.

I may, at this point, however, also caution the readers that an Implementation Guide is not a replacement of or a substitute for the original Standard(s) and must not therefore be read on a stand-alone basis. The Implementation Guide is meant to clarify and augment a practitioner’s understanding of the Standards and provide guidance where appropriate.

I am sure that the members would find this Implementation useful in implementing the Reporting Standards and making their audit reports more meaningful to the readers. I shall also eagerly look forward to your feedback on this Implementation Guide.

November 15, 2010 **CA. ABHIJIT BANDYOPADHYAY**
Kolkata Chairman
Auditing and Assurance Standards Board

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CHAPTER 1
INTRODUCTION

1.1 The *Standards on Auditing and Quality Control* are divided into two groups: Standards on Quality Control (which apply to quality control at the firm level) and the Standards on Audit (SAs) which apply to audits of historical financial information. The latter are further categorised into: Standards dealing with *(a)* general principles and responsibilities (200-series), *(b)* risk assessment and response to assessed risks (300 and 400-series), *(c)* audit evidence (500-series), *(d)* using the work of others (600-series), *(e)* audit conclusions and reporting (700-series); and *(f)* specialised areas (800-series).

SCOPE OF THE IMPLEMENTATION GUIDE

1.2 The scope of this Implementation Guide is limited to the SA 700, "Forming and Opinion and Reporting on Financial Statements", SA 705, "Modifications to the Opinion in Independent Auditor's Report" and SA 706, "Emphasis of Matter Paragraph and Other Matter Paragraph in the Independent Auditor's Report" that deal with how to form an audit opinion, reach audit conclusions and issue different types of auditor's reports.

1.3 These Standards are arguably the most important ones because they deal with processes that culminate into the end product of an auditor's work. They are crucial from an auditor's risk perspective because they lay down the principles and procedures on how an auditor forms his opinion and the manner in which he communicates the opinion, which determines how the society in general or specific stakeholders will make important economic decisions. In other words, the opinions and conclusions stated in an auditor's report and how those were reached will be what regulators and investigative agencies challenge in the event that something goes wrong subsequently. It is therefore of great professional concern that the practitioners appropriately understand

and carefully implement the Standards relating to these areas that are broadly referred to in this Implementation Guide as "*the Reporting Standards*".

1.4 Before the Clarity Project of the International Auditing and Assurance Standards Board (IAASB) that was completed in March 2009 and that of the Auditing and Assurance Standards Board of the ICAI that got completed in January 2010, the Reporting Standards were organised differently and there were far fewer of them. Presently, there are as many as 10 Standards that involve different types of reporting. It was for this reason that the Auditing and Assurance Standards Board of the Institute of Chartered Accountants of India considered it appropriate to issue this Implementation Guide that puts guidance on these diverse reporting requirements comprehensively into a single book.

1.5 It should, however, be noted that this Implementation Guide is not a replacement of or a substitute for the original Standard(s) and must not therefore be read on a stand-alone basis. It is meant to clarify and augment a practitioner's understanding of the Standards and provide guidance where appropriate. Practitioners are therefore urged to first read the relevant Standard(s) and refer to them as they use this Implementation Guide. For ease of usage, the issues have been dealt with in an easy-to-follow "Question – Answer" format.

CHAPTER 2
IMPORTANCE OF INDEPENDENT AUDITOR'S REPORT

2.1 Dependable financial information is essential to the very existence of our society. The underlying objective of an independent audit is to add credibility to the financial statements prepared by management.. Access to capital markets, mergers, acquisitions, and investments in an entity depend not only on the information that management provides in financial statements, but also on the assurance that such financial statements are free of material misstatements. This assurance is provided, to a considerable extent, by an independent audit. While an audit does not by itself guarantee accuracy of the financial statements, it provides users with a reasonable assurance that an entity's financial statements give a true and fair view in conformity with accounting pronouncements within the applicable financial reporting framework.

2.2 Whether it is a business granting trade credit, an investor buying or selling securities, a banker sanctioning a loan, or a government collecting taxes, stakeholders depend on financial information provided by the very people whose interests often run directly counter to their own. The help of an independent auditor, reputed for upright reporting, is what such stakeholders therefore seek.

2.3 The contribution of the independent auditor is therefore to give credibility to the financial statements. Credibility means that the financial statements can be believed; that is, they can be relied upon by stakeholders such as creditors, bankers, stockholders, government and other interested third parties as being true and fair.

2.4 Audited financial statements are now the accepted means by which business corporations report their operating results and financial position. The word “audit”, when applied to financial statements, means that the balance sheet, statements of profit and loss and cash flows, and the related accounting policies and notes which are covered by an auditor’s report given by an independent auditor, expressing his professional opinion as to the fairness or otherwise of the entity’s financial statements and the fact that in his view, the said financial statements are or are not (a) free from material misstatement due to fraud or error and (b) that they are fairly presented.

2.5 The goal is to determine whether these statements have been prepared in conformity with the generally accepted accounting principles (GAAPs). While financial statement audits in India are performed by chartered accountants, the key users of auditors’ reports include trade creditors, management, investors, bankers, financial analysts and government agencies.

2.6 The public perception of an auditor’s responsibility is often at variance with the auditor’s actual responsibility. This creates an “expectation gap” that clearly needs to be closed. To begin with, in public mind there is little distinction between a chartered accountant and an auditor. Many people believe that an auditor *prepares* the financial statements as well as handles all income tax matters from preparing and filing tax returns to managing assessment proceedings. Even the knowledgeable among users often do not know the distinction and the different degrees of assurance provided by an auditor’s report, an auditor’s certificate, a review report, a compilation report and an agreed-upon procedures report. What most people expect is that if a chartered accountant has put his signature and seal on a document, irrespective of whatever his report may say, that document must be completely free of fraud or error. If it is not, then they tend to hold the auditor responsible for the fraud or error.

2.7 Auditors, in the end, are providers of service to society. This “expectation gap” between them and the society that uses their services creates extremely onerous circumstances for auditors. Auditors therefore need to exercise every available opportunity to educate the users of their reports on the responsibilities of the management for preparing the financial statements versus their responsibilities, as auditors, to opine on those financial statements, based on the work they have done. They also need to amply stress that they are "independent" of the management.

CHAPTER 3

SA 700 FORMING AN OPINION AND REPORTING ON FINANCIAL STATEMENTS

INTRODUCTION TO THE STANDARD

3.1 The title of this Standard on Auditing (SA) gives no indication that, apart from this, there are a number of other SAs that one needs to look to for different types of reports. This SA deals with (a) how to form an opinion, and (b) how to give a '*clean'* opinion in the auditor's report on *the financial statements* of an entity that prepares *general purpose* financial statements.

3.2 There are other SAs to be followed if the opinion is modified (ie – qualified, disclaimer or adverse), or contains an emphasis of matter and/or other matters paragraph, or if the report is on special purpose financial statements or on a single financial statement (eg – audit of income statement alone) or of a specific element, account or item of a financial statement (eg – audit of receivables).

3.3 Nevertheless, one could say that SA 700 is like a parent of all reporting standards because it lays down the fundamental principles of reporting. The other reporting standards draw their structure from those principles. Given below are the key issues brought out in this Standard in a question – answer format.

Question 1: For which audits does the auditor need to follow this SA?

Response 1: The SA 700 is applicable for audits for financial statement for period begining on or after 1st April, 2011.

Question 2: The SA applies to audits of general purpose financial statements. What does that mean?

Response 2: To begin with, the SA applies to 'audits' and therefore not to engagements where a practitioner performs, for example, 'reviews' or 'compilations' or 'agreed-upon procedures'.

Secondly, the SA applies to audits of 'financial statements'. This includes the set of general purpose financial statements generally comprising of a balance sheet, statement of profit and loss (or income statement), cash flow statement, significant accounting policies and notes, and where applicable, statement of changes in equity. So, this SA does not apply to audits of a single financial statement or of a specific element, account or item of a financial statement.

Thirdly, 'general purpose' financial statements are those that are prepared in accordance with a 'general purpose financial reporting framework', which is a framework designed to meet the needs of a wide range of users as distinguished from a 'special purpose financial reporting framework' that caters to the needs of a specific set of users. Reports on special purpose financial statements are discussed in SA 800.

Question 3: A 'general purpose framework' includes two sub-groups – a 'fair presentation framework' and a 'compliance framework'. What are these?

Response 3: A fair presentation framework is where the auditor gives a "true and fair" report, whereas a compliance framework is one where the auditor reports on whether the financial statements comply with the requirements of the applicable laws, or rules and regulations, or a set of contractual terms and conditions. There can even be a mixture of the two such as when the auditor reports on the financial statements of a bank or a non-banking financial company (NBFC) that is regulated by the Reserve Bank of India (RBI), where part of the auditor's report is on compliance with RBI rules, and other part of the auditor's report is on the true and fair portrayal of the entity's financial position, performance and cash flows.

Technically, for a framework to be a fair presentation framework, it should meet the requirements of the framework and, to achieve this, the management has the freedom to (a) provide disclosures beyond those that are mandated by the framework or, (b) in rare cases, to even depart from the requirements of the framework in order to achieve a true and fair presentation. A compliance framework, on the other hand, requires meeting the requirements of the framework but does not give management such freedom.

Question 4: In an auditor's report there is an 'opinion paragraph' where he expresses his opinion on the financial statements (which could be a fair presentation opinion or a compliance opinion or a combination of both). How does an auditor decide whether he should give a 'clean' or 'unmodified' opinion?

Response 4: When he gives a clean opinion, the auditor says that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. Note (a) that he is forming his opinion on the whole set of financial statements taken together, and not on a component or element of those financial statements, and (b) his opinion is formed in the context of the overall 'materiality' of those financial statements.

In order to assert that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework, the auditor reaches a conclusion that those financial statements as a whole are free from material misstatement whether due to fraud or error.

To reach this conclusion, he has to determine whether:

(a) Sufficient appropriate audit evidence has been obtained in accordance with SA 330[1];

(b) Uncorrected misstatements are, individually or in the aggregate, material in accordance with SA 450[2];

(c) Requirements of the reporting framework (eg., the Accounting Standards) have been materially complied with;

1 SA 330, The Auditor's Responses to Assessed Risks.
2 SA 450, Evaluation of Misstatements Identified During the Audit.

(d) Management's judgements in preparing the financial statements are free from 'bias' (refer SA 260[3] and SA 540[4]);

(e) The financial statements adequately disclose the accounting policies selected and applied;

(f) Those accounting policies are (a) appropriate, and (b) consistent with the financial reporting framework;

(g) The accounting estimates made by management are reasonable;

(h) The information presented in the financial statements is relevant, reliable, comparable and understandable;

(i) There are adequate disclosures for users to understand the effect of material transactions and events on the information conveyed in the financial statements;

(j) The terminology used in the financial statements is appropriate, and the financial reporting framework is adequately referred to or described;

(k) In reporting under a fair presentation framework, the financial statements indeed achieve a true and fair presentation after considering –

- The overall structure and content of the financial statements, and that

- The financial statements, including notes, represent the underlying transactions in a manner that is true and fair.

If one considers the relevant body of GAAP (generally accepted accounting principles – which includes accounting standards and other pronouncements as well as the relevant law) that comprises the financial reporting framework with which the financial statements

[3] SA 260, Communication with Those Charged with Governance.
[4] SA 540, Auditing Accounting Estimates, including Fair Value Accounting Estimates and Related Disclosures.

must be in accord[5], as well as the auditor's responsibilities under the auditing standards and other pronouncements, reaching an audit opinion on a set of financial statements involves doing a *considerable* amount of diligent work, and documenting the work done, in order to be able to "prove" that he reached an informed opinion before signing a clean audit opinion. Issuing a clean opinion is, therefore, an outcome based on meticulous collection of evidence, detailed documentation of work performed, and analyzing it all with professional skill, competence and reasoned judgements.

Question 5: When should an auditor refuse to give a clean (unmodified) opinion?

Response 5: There can be two situations: (a) when the auditor has obtained sufficient appropriate audit evidence, and (b) when he was unable to obtain sufficient appropriate audit evidence.

In the first situation, he cannot give an unmodified opinion if he reaches a conclusion that the financial statements taken as a whole are not free from material misstatement(s). In the second situation, due to non-availability of sufficient appropriate evidence, he does not have the ability to reach a definite conclusion that the financial statements taken as a whole are free from material misstatement(s). In either situation, he must give a modified opinion under SA 705[6].

When reporting under a fair presentation framework, if the audtior concludes that fair presentation is not achieved, he should discuss the matter with management to resolve the issue (by giving additional disclosures or, in rare cases, departing from the framework) and, based on the outcome, decide whether he should give a modified opinion.

From this point on, please refer to the Appendix to the SA that gives Illustrative Formats of Auditor's Reports.

[5] See item (c) above.
[6] SA 705, Modifications to the Opinion in the Independent Auditor's Report.

Question 6: Is it necessary that an auditor's report should follow a particular form and style?

Response 6: Yes. Consistency in auditors' reports (as required under this SA) promotes credibility in the global marketplace. It helps to promote the users' understanding, and to identify unusual circumstances when they occur.

Question 7: What are the headings of the various paragraphs needed in an auditor's report?

Response 7: An auditor's report has the following paragraphs in the given order:

(a) Title

(b) Addressee

(c) Introductory paragraph

(d) Management's responsibility paragraph

(e) Auditor's responsibility paragraph

(f) Auditor's opinion paragraph

(g) Other responsibilities paragraph

(h) Signature

(i) Date of the auditor's report

(j) Place of signature

Question 8: What has changed in the *Title* of an auditor's report?

Response 8: The title of an auditor's report is now: *"Independent Auditor's Report"* as versus titles used earlier such as "*Auditor's Report*" or "*Audit Report*". The use of the word "Independent" is important in the context of the promulgation of SQC 1[7] (applicable to all engagements relating to accounting periods beginning on or after 1st April 2009). SQC 1 deals with quality control standards including those relating to auditor's responsibilities with regard to independence. Use of the word "Independent" affirms to a user that the auditor providing the report has met all of the relevant ethical requirements regarding independence and, therefore, distinguishes the independent auditor's report from reports issued by others.

Question 9: Who should the report be addressed to?

Response 9: As earlier, the auditor's report is usually addressed to those for whom it is prepared. For example, a report on year-end financial statements under the Companies Act, 1956 is addressed to the members of the company. Similarly, report on the financial statements of a partnership firm may be addressed to the partners, and a report on the financial statements of a government undertaking may be addressed to the President of India.

Question 10: What does the *Introductory paragraph* contain and what is the change *vis a vis* the erstwhile AAS 28*?

Response 10: Under the requirements of AAS 28, the management's responsibility and the auditor's responsibility were mentioned in a very summary/ concise form at the end of the Introductory paragraph. In the auditor's report under this SA, there are two separate paragraphs, each covering the responsibility of the management and the responsibility of the auditor.

Secondly, it was not the general practice to separately mention "summary of significant accounting policies and other explanatory information" along with the identification of the various financial statements on which an auditor reports. This SA specifically requires such a reference.

[7] SQC 1 Quality Control for Firms that Perform Audit and Reviews of Historical Financial Information, and other Assurance and Related Services Engagements

* Auditing and Assurance Standard (AAS) 28, "The Auditor's Report on Financial Statements".

Apart from this, the Introductory paragraph identifies the entity whose financial statements the report is being issued, states that the financial statements have been audited, identifies each statement that comprises the financial statements and specifies the date or period covered by each of the statements. In this there is a slight variance from the language used in AAS 28, for example the term "financial statements" was not being mentioned earlier, and the auditors used the term "*attached*" (w.r.t. balance sheet) as against the term "*accompanying*" (financial statements) used in this SA.

Note also that under the existing Indian GAAPs, the term "Profit and Loss Account" is redundant and incorrect. The correct term is "Statement of Profit and Loss". The auditors should request the clients to change the nomenclature of this statement so as to match it with that used in the accounting and auditing standards. Under other GAAPs, terms such as "Income Statement" or "Statement of Comprehensive Income" may be used, as appropriate.

Likewise, "*Notes to Accounts*" is also a redundant and incorrect term. The correct term is "*Notes to the Financial Statements*". However, in this SA, the term used is "*Summary of Significant Accounting Policies and Other Explanatory Information*", and that term should now be used. The auditors should request the clients to also change this nomenclature so as to match it with that used in the auditing standards.

In other GAAPs, there may also be additional statements such as the "*Statement of Changes in Equity*" that form part of the financial statements.

Question 11: What is *Management's Responsibility paragraph*?

Response 11: It is important for the users of the financial statements to explicitly know that the independent auditors do not share the responsibility for the preparation of the financial statements on which they report. This is therefore an important paragraph that clarifies the limit of the auditor's responsibility.

The word 'management' is illustrative. It may be substituted by the designation of whoever in the entity is actually responsible for the preparation of financial statements. For example, in case of a partnership firm , it would be the partners.

Note that it is inappropriate for an auditor to describe management's responsibility in his report unless the management and he have clearly agreed on it. It is therefore very important for the auditor to include the exact language that he intends to insert in his auditor's report on management's responsibility in the engagement letter that is signed by both parties at the start of the audit.

The illustrative language of a management's responsibility paragraph (in a fair presentation framework scenario) is as under:

<< 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 accounting principles generally accepted in India; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. >>

In circumstances where the nature of the entity or its jurisdiction casts additional responsibilities on the management in respect of the financial statements, the auditor may deem it appropriate to suitably add those in this paragraph as well as in the engagement letter.

A question that arises is that if the auditor finds that the internal controls are not up to expectation, should he '*qualify*' the management's responsibility paragraph? The answer is clearly "no". A responsibility paragraph cannot be qualified. This paragraph's limited purpose is to recite the fact that management is responsible for the design, implementation and maintenance of internal controls. If the auditor subsequently finds that their design, implementation or maintenance is so poor that it requires qualification, the place to make that qualification would be in the auditor's opinion paragraph (and the report under the Companies (Auditor's Report) Order, 2003, where applicable.)

Question 12: What is the *Auditor's Responsibility paragraph*?

Response 12: Like the management's responsibility paragraph, the auditor's responsibility paragraph is also an important paragraph since the auditor makes certain very important assertions in this paragraph about the work that he has done.

The illustrative language of an auditor's responsibility paragraph (in a fair presentation framework scenario) is as under:

<< 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 of 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 of 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 Company's internal control*[8]. *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 statements.*

[8] 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 statements, 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 statements in order to design audit procedures that are appropriate in the circumstances."

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion. **>>**

A key assertion that is made in this paragraph is that the audit was conducted in accordance with the SAs. SA 200[9], which in a way is the "parent standard" on auditing, prohibits the auditor from representing compliance with SAs in the auditor's report unless the auditor has complied with the requirements of this SA and all other SAs relevant to the audit.

This is a very broad and onerous assertion for an auditor to make. If during a subsequent review of the audit process, it is found that some of the audit procedures detailed in the SAs were not in fact complied with, it may tantamount to the auditor making a deliberately false declaration in his report and the consequences for the auditor could be very serious indeed.

It would therefore be advisable for the practitioner signing the audit report to ensure that the audit team plans and performs audits in a way that covers all the relevant SAs. Subsequently, when reviewing the audit file, he should ensure that the auditing standards compliance checklist (including compliance with SQC 1[10]) has been thoroughly looked into. If, in certain circumstances, a departure has been made from compliance with SAs, a detailed memorandum explaining the reasons for such departure and the alternate procedures performed to overcome such non-compliance should be kept in the audit working papers file.

It is one thing to have done the work and another to be able to prove that such work was indeed done. Notwithstanding the Standard dealing with Documentation, SA 230[11], and other specific references to documentation in other SAs, looking to the generality of the assertion being made, an auditor would be well advised to adequately document the work performed and conclusions arrived

[9] SA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing.

[10] SQC 1, Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements.

[11] SA 230, Audit Documentation.

at. This is especially critical in instances where the auditor has applied his professional judgment in a situation where more than one view might have been possible.

Question 13: Where does Section 227(3) and 227(4A) of Company Act, 1956 reporting go if Auditor's Opinion paragraph immediately follows the responsibility paragraphs?

Response 13: This is one major departure from the form of auditor's report that was earlier used in terms of the requirements of AAS 28. Earlier, in case of audit report of a company, the auditor's opinion/ findings in respect of a number of assertions such as in respect of CARO, about obtaining all the information and explanations, books of account, agreement of financial statements with books of account, compliance with accounting standards, directors' disqualification under section 274(1)(g), etc, were given in the auditor's report *before* giving his audit opinion on the financial statements.

In fact, these are the assertions that are required to be made by the auditor not in order to give an opinion on the true and fair financial position, performance or cash flows, but to comply with the specific requirements of section 227(3) or (4A) of the Companies Act, 1956. By reporting on these assertions and, simultaneously, giving below them an audit opinion on the true and fair financial position, performance or cash flows, made it appear to the user that these assertions were also essential for an auditor in forming his true and fair opinion on the financial statements. This is not correct. Even if the finding/ opinion of the auditor in respect of one or more of these assertions is negative, it does not by itself preempt the auditor from issuing a clean opinion under this SA provided, as a result of his audit performed in accordance with the SAs, he is satisfied that the financial statements have been prepared in accordance with the financial reporting framework and, taken as a whole, are free from material misstatement(s).

This SA therefore divides the auditor's report into three sections: (a) the general section prior to the responsibility paragraphs, (b) the responsibility paragraphs and the auditor's opinion paragraph, and (c) report on other legal and regulatory requirements. This means that the fair presentation opinion on the financial statements is clearly separated from the opinion on compliance matters. This reflects the situation correctly, while also meeting the requirements of law.

Question 14: What happens if wording of Auditor's Opinion is prescribed by law or regulation?

Response 14: The wording of an auditor's report (including the auditor's opinion) may sometimes be prescribed by the law or regulation applicable to the client. While mostly that is not the case, it is possible that the prescribed terms may be significantly different from the requirements of SAs.

When this is so, SA 210[12] requires an auditor to evaluate:

- Whether users might misunderstand the assurance obtained from the audit, and if so

- Whether providing additional explanation in the auditor's report can mitigate such misunderstanding.

Where he concludes that even additional explanation in the auditor's report cannot mitigate possible misunderstanding, SA 210 requires the auditor not to accept the audit engagement.

If the applicable law or regulation compels an auditor to accept such an engagement, then as per SA 210 such an audit does not comply with the SAs. The auditor when reporting on such audit therefore does not include any reference to the audit having been conducted in accordance with the SAs in his auditor's report.

Question 15: How is an unmodified opinion worded generally in case of a fair presentation framework and in case of a compliance framework?

Response 15: The opinion paragraphs given in the illustrative reports given at the end of this SA are reproduced below.

[12] SA 210, Agreeing the Terms of Audit Engagements.

Under a fair presentation framework:

For non-company entities –

<< In our opinion, the financial statements give a true and fair view of the financial position of ABC Company as at December 31, 20X1, and of its financial performance and its cash flows for the year then ended in accordance with accounting principles generally accepted in India. **>>**

Under a compliance framework:

<< In our opinion, the financial statements of ABC Company for the year ended December 31, 20X1 are prepared, in all material respects, in accordance with XYZ Law of Jurisdiction X. **>>**

Question 16: How should an unmodified opinion be worded in case of a fair presentation framework under the Companies Act?

Response 16: Considering the fact that Schedule VI of the Companies Act, 1956 prescribes the form and contents of the financial statements of companies in India, it is appropriate for the auditor to word the opinion paragraph in conformity with Section 227(2) of the Act to the extent that it meets the spirit (rather than the letter) of the law as well as meets the needs of this SA.

The following wording should be used:

<< In our opinion and to the best of our information and according to the explanations given to us, the financial statements give the information required by the Companies Act, 1956, in the manner so required and give a true and fair view of the financial position of ABC Company Limited as at March 31, 20X1, and of its financial performance and its cash flows for the year then ended, in accordance with accounting standards referred to in sub-section (3C) of section 211 of the said Act. **>>**

Note that presently the financial reporting framework that we call "accounting principles generally accepted in India" comprises of the Accounting Standards issued by the Institute of Chartered Accountants of India that are applicable to non-company entities. For companies, the financial reporting framework comprises of and should be described as the "*Accounting Standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956".*

Question 17: Is it possible for the financial statements to be prepared in accordance with two financial reporting frameworks and if so, how is auditor's opinion expressed?

Response 17: If, for instance, the local country GAAP of a jurisdiction is only very slightly different from the IFRSs, the management may prepare a single set of financial statements that are simultaneously in accordance with both the financial reporting frameworks.

Each framework is considered separately in forming an auditor's opinion. If the financial statements are found to be in compliance with each of the frameworks, the auditor may issue two separate opinions, one for compliance with each framework, in either two different sentences or in a single sentence, eg, "*the financial statements give a true and fair view in accordance with the accounting principles generally accepted in India and with International Financial Reporting Standards*".

If they are in compliance with one framework but not the other, an unmodified opinion may be given on the former under this SA and a modified opinion on the latter under SA 705.

Question 18: If the financial statements are prepared as per one framework but contain information on the extent of compliance with another framework, what is the auditor's responsibility in such a situation?

Response 18: Such a case could be for example where the Notes to the Financial Statements include a Note giving reconciliation of Indian GAAPs profit with, say, US GAAPs. As this information forms part of the financial statements it gets covered by the auditor's opinion.

What this means is that the financial statements as covered by the auditor's report in effect assert that the said reconciliation to US GAAP is free of material misstatement due to fraud or error. In order to be able to make such an assertion the auditor would obviously have to audit this financial information (ie, the reconciliation) and obtain his audit assurance that the numbers in the reconciliation are arrived at after considering all the applicable provisions of US GAAPs and are in compliance with at least the recognition and measurement principles of US GAAPs.

Question 19: How should an auditor frame his opinion where a statute or court order or government directive/ permission allows an entity to prepare financial statements without meeting a GAAP requirement?

Response 19: Sometimes the Central Government or a court of law, say, at the request of the entity, permits it to follow a specific accounting treatment in respect of a particular transaction. For example, an entity may be permitted to account for a certain type of income or expenditure on cash basis or on a deferral basis that may not be permitted by the Accounting Standards. The question is whether a departure from the framework under such circumstances requires an auditor to qualify his report?

The answer is "*no*". In such a situation, the departure is not a non-compliance with the framework but compliance with a modified framework. If the effect of doing this is material, the auditor should describe the resultant deviation from the framework in sufficient detail in an emphasis of matter paragraph.

Question 20: In reply to Question 13 it was mentioned that the report on other legal or regulatory requirements is separated from the opinion paragraph. How is that done?

Response 20: For example, under the Companies Act, 1956, the auditors are required to answer a set of questions pertaining to the entity under the Companies (Auditor's Report) Order, 2003 (CARO). The answers are normally given in an Annexure that is referred to in the auditor's report. Under this SA, the same situation continues but the reference paragraph in the auditor's report comes in a separate section of the report following the opinion paragraph. This section may be titled "*Report on Other Legal and Regulatory Requirements*".

Another example is of the assertions required to be made under section 227(3) of the Companies Act, 1956 on obtaining all the information and explanations necessary for audit, keeping of proper books of account, agreement of balance sheet and statement of profit and loss with the books, compliance with accounting standards prescribed under section 211(3C), disqualification of directors, and cess leviable under section 441A. All these assertions are made *after* the opinion paragraph in the "*Report on Other Legal and Regulatory Requirements*" section. If any of these assertions is negative or partial, that fact needs to be brought out while reporting on that assertion.

The question one may ask is whether the audit opinion will be qualified if one or more of the legally required assertions above is negative. The answer will depend on the merits of each case. For example, if there has been a material departure from Standards prescribed under section 211(3C) as reported in the "*Report on Other Legal and Regulatory Requirements*" section of the report, the opinion will also obviously need to be qualified or adverse. If all the information and explanations have not been provided, it is likely that there may have been a scope restriction on the audit which, if material, would require a disclaimer of opinion. But if a director is disqualified from being a director, that would have no bearing on the true and fair view of the financial statements, and a clean opinion may be given.

Question 21: How does an auditor sign an auditor's report?

Response 21: The SA mentions that "Where the firm is appointed as the auditor, the report is signed in the personal name of the auditor and in the name of the audit firm." The intention of the SA here is not to have two separate signatures, one in personal name and one in the firm name, but that the partner signing should sign in his personal name *for and on behalf of the firm* which has been appointed as the auditor with the name and registration number of the firm also mentioned as signatory.

Where a firm is appointed as auditor, the suggested manner to sign would be:

For XYZ and Co
Chartered Accountants
Firm's registration number

Signature
Name of the signing member
Designation (partner/ proprietor)
Membership number

Place of signature
Date:

Question 22: What is the significance of the date of the auditor's report?

Response 22: Date of the auditor's report informs the user that the auditor has considered subsequent events up to that date in making his report[13] and makes the auditor responsible for events and transactions up to that date.

Secondly, since the financial statements are the responsibility of management, the auditor's report should not be signed before the date of approval of the financial statements by the board of directors or equivalent governing body. It may, however, be dated after the

[13] It is therefore important to ensure that the working paper on subsequent events is dated the same as the date of the auditor's report and has been reviewed as at that date by the signing partner.

date of the board meeting in which the financial statements are approved.

Question 23: Can an auditor sign the auditor's report at a place other than the city where the registered office of the entity is situated? Do the directors and auditor need to sign the financial statements at the same location?

Response 23: The SA 700 does not contain any such requirement or mandate. An auditor should mention the name of the place where he signs the report. For example, if the auditor signs the report when he is in Hyderabad, he should mention the place of signature as Hyderabad, irrespective of the fact that the registered office of the entity is in New Delhi or that directors may have signed the financial statements in Mumbai.

Question 24: How does the auditor comply with this SA if the law or regulation prescribes a format of auditor's report that is different from the format required under this SA?

Response 24: This situation frequently confronts an auditor in India. Various laws and regulatory agencies prescribe the form in which they expect the auditor's report to be given. This often creates a hard situation for an auditor as he finds that he has performed audits as per the SAs but the form in which he is required to report puts a greater burden on him. For example, there are situations when the auditor is expected to "certify" the financial statements or to attest them as being "true and correct" rather than "true and fair". Also, in most cases the form does not have the management's and auditor's responsibility paragraphs.

The advice to auditors is that wherever they have the liberty to modify the prescribed format to broadly bring it in line with the requirements of this SA, they should do so to the extent possible. This is important from the viewpoint of achieving the fundamental objective of this SA, namely, to achieve consistency in reporting that promotes credibility for an auditor's report in the marketplace. So, for example, if the prescribed report does not have the responsibility paragraphs, he may insert them without disturbing the other layout of the prescribed report.

This SA requires that if the difference between the prescribed format and this SA are only in layout and some wording, the auditor needs to assess if, at a minimum, the various elements required under paragraph 43 of this SA form a part of the prescribed format. If they are all there but in a different layout, he may give his report in the prescribed form so long as the basic principles of the SA are met.

Paragraph 43 mentioned above requires an auditor's report to contain, at a minimum, the following elements: (a) title, (b) addressee, (c) introductory paragraph to identify the financial statements audited, (d) management's responsibility, (e) auditor's responsibility for the audit wrt SAs/ laws/ regulations, (f) opinion wrt the applicable financial reporting framework, (g) signature, (h) date, and (i) place of signature.

However, if the prescribed form of the report does not include the minimum elements required under paragraph 43 of this SA and if the auditor does not have the liberty to change the format to include the missing elements, then he ***cannot*** include a statement in the auditor's responsibility paragraph of the report that "*We conducted the audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India.*" As regards the other assertions that are made in the auditor's responsibility paragraph or elsewhere in the report, the auditor will have to determine if it is appropriate in the circumstances for him to make those assertions or if he should modify them to suit the exact circumstances.

It goes without saying that in no event should an auditor accede to making an assertion for which he has not been able to perform adequate procedures or for which there was a scope limitation or inadequate evidence. Under such circumstances, the auditor is well advised to give a modified report under SA 705 or an emphasis of matter paragraph under SA 706, as may be appropriate.

Question 25: Can an audit be done under two different sets of auditing standards: such as the SAs and International Standards on Auditing (ISAs)? How will reporting be done in such a situation?

Response 25: This situation often arises when Indian GAAP financial statements of a subsidiary or branch of a foreign company are statutorily audited for local filing under SAs; and for parent reporting where audit under ISAs is required, assuming that the year-ends are the same for both the reports. In such a situation, an auditor performs audit procedures that simultaneously meet the requirements of both sets of Standards, in order that he does not have to do two audits.

If the two sets of Standards do not have any conflict that would require the auditor to form a different opinion under each of them, his report may refer to compliance with *both* Standards by specifically naming them in his report. Eg "*We conducted the audit in accordance with the Standards on Auditing issued by the Institute of Chartered Accountants of India and the International Standards on Auditing*".

If a conflict exists, the auditor needs to give two separate auditor's reports where, for example, one could include a clean opinion and the other may include an emphasis of matter paragraph or modified opinion as may be necessary.

Question 26: How does an auditor deal with a situation where the audited entity voluntarily provides supplementary information or where a law or regulation requires additional information that is outside the scope of the applicable financial reporting framework?

Response 26: Supplementary information, in this context, should not be confused with "*Other Legal Or Regulatory Requirements*" mentioned in Questions 13 and 20 above.

Where there is such information embedded in the financial statements, the auditor discusses with the client if such information could be displayed separately outside the financial statements. If that is possible, there is no further issue.

Where such supplementary information (eg., a GAAP reconciliation between Indian GAAP and IFRSs included in the Notes to the

Financial Statements) cannot be clearly differentiated from the rest of the financial statements, the auditor's opinion shall have to cover that too. This means that the auditor would need to audit this information and report on it in the ordinary course.

If the management (or law/ regulation) requires such information not to be subjected to audit, the auditor must ensure that such information is presented in a way that clearly shows that it is "unaudited". For example, if prior period numbers that were not audited are presented as comparative information, the columns giving such information could be clearly labeled as "*Unaudited*" and an explanatory note may be given to explain why such unaudited information is presented. Alternatively, the Notes to the Financial Statements that include such information could be put in a separate section of the Notes that is clearly labeled as "*Unaudited*".

A question arises as to whether the auditor will have any responsibility for the supplementary information included in the financial statements if it is labeled as "Unaudited"? The answer is "*yes*". Under SA 720[14] the auditor still has the responsibility to read that information to identify if it contains any material inconsistency with the audited financial statements. If so, he will have to deal with it as per SA 720.]

[14] SA 720 The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements

CHAPTER 4

SA 705 MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT

Question 27: What is the difference between a "qualified" auditor's report and a "modified" auditor's report?

Response 27: In fact, it is not the auditor's report which is "qualified" or "modified", it is the audit opinion within the auditor's report which can be a "qualified opinion" or a "modified opinion".

When the auditor has no reservation on the financial statements (beyond the tolerance limits of materiality), he gives what is generally called a "*clean*" opinion. This is an auditor's report containing an "unmodified opinion" governed by SA 700 that has been discussed in Chapter 3.

Then there are auditor's reports containing "modified opinions". These are issued where the auditor has some reservation about the financial statements. Under SA 705[15] there can be three types of "modifications" to an auditor's opinion: (a) a "qualified opinion", (b) a "disclaimer of opinion", or (c) an "adverse opinion".

So, a qualified opinion is one kind of a modified opinion, the other two being either a disclaimer or an adverse opinion. When an audit opinion is other than "clean", the standard language of the opinion in SA 700 is *modified* to express the auditor's reservation about the financial statements.

Question 28: How does one decide the nature of modification that should be made?

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[15] Under the erstwhile AAS 28, inclusion of an emphasis of matter paragraph was also considered as a "modified" opinion. SA 705 no longer considers it as such.

Response 28: An auditor has to evaluate the situation carefully before making his judgment as to the nature of modification. It is very important that he, in terms of the principles laid down in SA 230, *Audit Documentation,* also documents in his work papers how and why he reached this professional judgment.

There can be two situations:

(a) There is a matter for which the auditor *has* sufficient appropriate audit evidence to determine that due to such matter the financial statements *are* materially misstated, and

(b) There is a matter for which the auditor *is unable to obtain* sufficient appropriate audit evidence to determine whether due to it the financial statements *may be* materially misstated.

In either case the report will be modified, but the nature of modification can be different.

After this, the auditor uses his professional judgment to determine if the *effects* or *possible effects* of the matter on the financial statements is/ are *pervasive* or *not pervasive.* Again, depending on the extent of pervasiveness, the nature of modification can be different.

The following table summarises the criteria and the nature of modification:

Nature of matter giving rise to modification	***Auditor's judgment about the Materiality and Pervasiveness of the Effects or Possible Effects on the financial statements***	
	Material but Not Pervasive	**Material and Pervasive**
FS are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

Question 29: What is a 'material misstatement'?

Response 29: For financial statements to comply with an applicable financial reporting framework, the transactions and events as reflected therein need to comply with four aspects. These are:

(a) Recognition

(b) Measurement

(c) Classification and presentation, and

(d) Disclosure

A "*misstatement*" of the financial statements occurs when there is a difference between how each of these aspects is reported by the management in the financial statements and how it should be as per the applicable financial reporting framework.

As per SA 450, *Evaluation of Misstatements Identified during the Audit*, 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.

The selected accounting policies may not be consistent with the applicable financial reporting framework, or the financial statements (including the Notes) do not reflect the events and transactions in a manner that achieves fair presentation, for example, where a change in policy from prior period is not adequately reported. There might also be inconsistency in application of policies between periods or transactions and events of a similar nature or the method of application of the policy is erroneous. As regards disclosures, all of the required disclosures may not be given or, if given, may not be presented as they should be, or the financial statements may not give disclosures that ensure a fair presentation (that is, they do not contain disclosures of events or transactions that are needed to properly reflect a true and fair view).

It is often wrongly believed that a "*material misstatement*" is only a recognition and measurement issue alone. In other words, there is a perception that one does not need to modify an opinion unless the rupee amounts are misstated. Due to this perception, auditors may fail to modify their opinion in respect of material misstatement of the financial statements caused by inappropriate classification or presentation, or inadequate disclosure.

Modifying an audit opinion where such modification is warranted is a very important decision that an auditor has to make. It is a decision that may subsequently be challenged by the client, or called into question by a regulator, or by investigating agencies and courts of law in the course of a fraud investigation. Therefore, in reaching his decision on modifying or not modifying an auditor's report, the auditor should ensure that the decision is not only in accordance with the related accounting and auditing pronouncements but one that will stand up to scrutiny.

It is therefore crucial for an auditor, when making an evaluation for purposes of modifying or not modifying an audit opinion to properly understand the meaning, context and importance of these three key concepts: "*evidence*", "*materiality*" and "*misstatement*". Each of these topics have been dealt with in separate Standards on Auditing. For example:

- SA 320, *Materiality in Planning and Performing an Audit*
- SA 450, *Evaluation of Misstatements Identified during the Audit*
- SA 500, *Audit Evidence*
- SA 501, *Audit Evidence – Specific Considerations for Selected Items*
- SA 505, *External Confirmations*
- SA 570, *Going Concern*

Since the entire suite of SAs has undergone substantive revision under the Clarity Project, auditors are well advised to study these concepts afresh.

Question 30: What is inability of an auditor to obtain sufficient appropriate audit evidence?

Response 30: Ordinarily, an auditor would be unable to obtain sufficient appropriate audit evidence in the following situations:

(a) *Circumstances beyond the control of an entity* – For example, the entity's accounting records are destroyed by fire or are seized by an investigating agency;

(b) *Circumstances related to the nature and timing of the auditor's work* – Examples: (a) for equity accounting of an associate, adequate financial information of the associate is not available; (b) the auditor is appointed after year-end and is therefore unable to observe physical verification of inventory; or (c) where the controls of the entity are not effective and the auditor concludes that performing substantive procedures alone is not sufficient;

(c) *Limitation imposed by management* – For example, management prevents the auditor from observing inventory count or from requesting external confirmation of specific account balances, or imposes unrealistic time deadlines within which to issue an auditor's report.

Question 31: If the management imposes a scope limitation after the auditor has accepted the engagement, what should he do?

Response 31: As a first step, the auditor should request the management to remove the scope restriction. If the management refuses, he should communicate with those charged with governance and simultaneously explore ways to perform alternative procedures to obtain sufficient appropriate audit evidence.

If the auditor concludes that he is still unable to get sufficient appropriate audit evidence, he should determine if the possible effect of undetected misstatements is likely to be material but not pervasive. If so, he should qualify his opinion.

If he concludes that the possible effect of undetected misstatements is likely to be both material and pervasive and qualification alone would not suffice, he should resign from the audit if permitted to do so by the applicable law or regulation. But where the law or regulation does not permit resignation of the auditor for such reason after accepting an audit, he should give a disclaimer of opinion.

Question 32: When is the effect of a misstatement or a possible misstatement considered to be "*pervasive*"?

Response 32: As can be seen from the question itself, both a material misstatement (where evidence is available) and a possible misstatement (where evidence is not available) are to be evaluated for being pervasive or otherwise. (Refer the table in response to Question 27.)

The effect of a material misstatement/ possible misstatement is *pervasive*, when:

(a) Where it pertains to an amount(s) in the financial statements, it is not confined to specific components, accounts or items of the financial statements. If it is so confined, it represents or could represent *a substantial portion* of the financial statements; or

(b) Where it pertains to disclosures, such disclosures or the matter(s) therein are/ could be *fundamental* to the user's understanding of the financial statements.

For example, where an auditor detects a bias in the valuation of estimates on the assets side of a balance sheet (such as increasing the useful lives of fixed assets without justification, not treating impairment in investments as other than temporary, treating doubtful receivables as good, not providing adequately for inventory obsolescence, etc.) all building up to an overstatement of earnings, the aggregate effect of which may be material to the financial statements taken as a whole, the possible misstatement is said to be pervasive.

In another example, when the misstatement is only in valuing inventory of a major raw material at cost in stead of at net realisable value when clear evidence is available that the fair value of the material was substantially lower than cost and the selling price of the finished product is pegged to current raw material prices, and the difference in valuation, if booked, could wipe out a substantial portion of the profit before tax of the entity, the misstatement is said to be pervasive.

In yet another example, the entity is unable to resolve to the satisfaction of the auditor a going concern issue in relation to one of its major subsidiaries in which the entity has substantial exposure in terms of equity, debt and guarantee commitments and it refuses to either make a provision or a satisfactory disclosure of the matter, the misstatement is said to be pervasive.

Question 33: There is a misstatement or a series of misstatements in the financial statements that the auditor evaluates as material and pervasive to the financial statements, singly or in the aggregate. The auditor explains each such misstatement by giving separate paragraphs in his report and then states in his opinion that '*subject to the matters stated in the said paragraphs, the financial statements give a true and fair view*'… Is this permissible?

Response 33: No. The auditor's duty is to evaluate if the effect of all the misstatements and possible misstatements in the aggregate is material and pervasive to the financial statements taken as a whole. If that is true, he cannot give an overall qualified opinion. He has to give an adverse opinion. This means he has to state in the audit opinion that the financial statements *do not give* a true and fair view. This is a very important and significant matter where professional judgement needs to be well-founded.

Question 34: There is a possible misstatement or a series of possible misstatements in the financial statements or a mix of misstatements and possible misstatements that the auditor evaluates as material and pervasive to the financial statements, singly or in the aggregate. The auditor explains each such misstatement by giving separate paragraphs in his

report. In case of misstatements he quantifies the impact thereof. In case of possible misstatements he states the matter and expresses his inability to quantify the impact thereof in the absence of availability of evidence. He then states in his opinion that subject to the matters stated in the said paragraphs, the financial statements give a true and fair view… Is this permissible?

Response 34: No. The auditor's duty is to evaluate if the possible effect of a single possible misstatement or a number of possible misstatements taken together is likely to be material and pervasive to the financial statements taken as a whole. If that is true, he cannot give an overall qualified opinion. He has to give a disclaimer of opinion. This means he has to state in his audit opinion that due to the significance of the matters described, he has been unable to obtain sufficient appropriate audit evidence, and accordingly he *is unable to express an opinion* on the financial statements.

In case of a mix of misstatements and possible misstatements that are singly and/or collectively evaluated as being material and pervasive, the auditor would have to decide if his opinion should be adverse or a disclaimer. It cannot be both, a disclaimer for some matters and adverse in respect of others as such reporting would confuse the users. In such cases, the auditor should give an adverse opinion. This means he has to state that the financial statements *do not give* a true and fair view.

Question 35: In the situations described in Questions 32 and 33, if the misstatements or possible misstatements or a mix of the two are evaluated by the auditor as being material but not pervasive to the financial statements, can he give a narration of the material misstatements, possible misstatements or a mix of the two in separate paragraphs of his report and then, giving reference to those paragraphs, state that '*subject thereto the financial statements give a true and fair view*'…?

Response 35: Yes. Where the aggregate effect of misstatements or possible misstatements is material but not pervasive, the auditor can express a qualified opinion.

Question 36: What does this bring out in terms of an auditor's responsibility for correct reporting?

Response 36: The auditor's opinion on a set of financial statements is read very keenly by a variety of users who make important economic decisions based on it. The distinction between a clean opinion, a qualified opinion, a disclaimer of opinion and an adverse opinion is therefore critical for such users. An opinion that is inappropriately worded could result in a user making a wrong economic decision that could have significant financial implication and for which he could hold the auditor to be accountable.

Using professional judgement in making his decision for modifying or not modifying his opinion is of course the privilege of an independent auditor. But such professional judgement has to be made within the framework of the accounting and auditing standards, in keeping with the competencies expected from the training, knowledge and experience of the auditor, as well as due processes of internal/ external consultation and documentation. It is important therefore to understand what using "professional judgement" entails.

SA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing*, deals with the subject of professional judgement as well as with other fundamental matters of great importance to auditors. Extracts from that SA are given below for ready reference:

"Professional Judgment

16. The auditor shall exercise professional judgment in planning and performing an audit of financial statements. (Ref: Para. A23-A27)

Professional Judgment *(Ref: Para. 16)*

A23. Professional judgment is essential to the proper conduct of an audit. This is because interpretation of relevant ethical requirements and the SAs and the informed decisions required throughout the audit cannot be made without the application of relevant knowledge and experience to the facts and circumstances.

Professional judgment is necessary in particular regarding decisions about:

- *Materiality and audit risk*
- *The nature, timing, and extent of audit procedures used to meet the requirements of the SAs and gather audit evidence*
- *Evaluating whether sufficient appropriate audit evidence has been obtained, and whether more needs to be done to achieve the objectives of the SAs and thereby, the overall objectives of the auditor*
- *The evaluation of management's judgments in applying the entity's applicable financial reporting framework*
- *The drawing of conclusions based on the audit evidence obtained, for example, assessing the reasonableness of the estimates made by management in preparing the financial statements.*

A24. The distinguishing feature of the professional judgment expected of an auditor is that it is exercised by an auditor whose training, knowledge and experience have assisted in developing the necessary competencies to achieve reasonable judgments.

A25. The exercise of professional judgment in any particular case is based on the facts and circumstances that are known by the auditor. Consultation on difficult or contentious matters during the course of the audit, both within the engagement team and between the engagement team and others at the appropriate level within or outside the firm, such as that required by SA 220 assist the auditor in making informed and reasonable judgments.

A26. Professional judgment can be evaluated based on whether the judgment reached reflects a competent application of auditing and accounting principles and is appropriate in the light of, and consistent with, the facts and circumstances that were known to the auditor up to the date of the auditor's report.

A27. Professional judgment needs to be exercised throughout the audit. It also needs to be appropriately documented. In this regard, the auditor is required to prepare audit documentation sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the significant professional judgments made in reaching conclusions on significant matters arising during the audit. Professional judgment is not to be used as the justification for decisions that are not otherwise supported by the facts and circumstances of the engagement or sufficient appropriate audit evidence."

It should also be noted that when an auditor expects to give a modified opinion, he has a duty to first discuss the matter giving rise to the expected modification with those charged with governance which generally means with the audit committee, board of directors, or equivalent governing body, and not just with the management or the Chief Financial Officer.

Question 37: If there are multiple uncertainties, but for each of those uncertainties the auditor has been able to obtain sufficient appropriate audit evidence, can he still give a disclaimer of opinion on the financial statements?

Response 37: Such a situation is rare but possible. If the auditor concludes that notwithstanding his having obtained sufficient appropriate audit evidence regarding individual uncertainties, it is not possible for him to form an overall opinion on the financial statements due to the possible interaction of the uncertainties and their possible cumulative effect on the financial statements, he would need to give a disclaimer of opinion.

Question 38: Can an auditor give an unmodified opinion in respect of one (or more) financial statements or account or element or item of a financial statements while giving an adverse or disclaimer of opinion on the financial statements as a whole?

Response 38: No. If an auditor is engaged to audit and report on the financial statements of an entity and he concludes that his overall opinion on those financial statements is either disclaimer or adverse, he cannot give in the same report an unmodified opinion in respect of a single financial statement or an account or element or item of a financial statement.

However, if he is engaged to audit and report under SA 805, *Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement*, where his engagement is to audit and report on a single financial statement or a specific account or element or item of a financial statement, he may give a separate unmodified report under that SA. The two reports, one under SA 805 and the other on the audit of financial statements as a whole must be separate with separate terms of engagement.

In another situation where an auditor is engaged to report on a set of financial statements under two different financial reporting frameworks – say Indian GAAP and IFRSs, and in stead of giving separate reports under each GAAP, he chooses to issue a combined report, he may give an unmodified opinion on the financial statements under one framework but an adverse opinion or disclaimer of opinion under the other framework. In such circumstances, he would have to word the report carefully in order to prevent any misinterpretation of his intent by the users.

Thirdly, even where he is appointed to audit and report on the financial statements as a whole, it would be possible for an auditor to give, for example, a disclaimer of opinion on the results of operations and cash flows but an unmodified opinion on the financial position of the entity in a situation envisaged under *SA 510, Initial Audit Engagements – Opening Balances*, paragraphs 10 and A5. In this situation, he does not express any overall audit opinion on the financial statements as a whole.

Question 39: Is there a difference in the way an audit opinion is modified now?

Response 39: Yes. First, it may be reiterated that inserting an Emphasis of Matter paragraph or an Other Matters paragraph (new concept) in the auditor's report is no longer considered to be a "modification" of the audit opinion. A separate Standard *viz*., SA

706 Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report now deals with these.

Secondly, the matter giving rise to modification is now to be described in a separate Basis for Modified Opinion paragraph that may be titled as "*Basis for Qualified Opinion*" or "*Basis for Adverse Opinion*" or "*Basis for Disclaimer of Opinion*", as may be appropriate. Accordingly, the opinion paragraph that follows is also clearly titled as "*Qualified Opinion*" or "*Adverse Opinion*" or "*Disclaimer of Opinion*", respectively and refers to the matter given in the Basis for Modified Opinion paragraph.

Earlier, under the AAS 28, there was no requirement to give a title to the basis for modified opinion paragraph or to the opinion paragraph. As can be seen, the objective of this change is to help the user clearly understand which part of an auditor's report is actually the audit opinion and what exactly is the modificatory matter.

Question 40: What does the Basis for Modified Opinion paragraph contain?

Response 40: If there is a material misstatement in the financial statements that relates to specific amounts, including amounts given in the Notes, the auditor gives a description and a quantification of the misstatement. Where an accurate quantification is not possible but a management estimate is available, the auditor performs such audit tests on those management estimate as are possible, and clearly indicates that the amount quantified is based on management's estimate. (This could be put in a Note with the auditor drawing reference to the Note in his report.) If it is impracticable for him to quantify or estimate the effect of the misstatement, he states so in the Basis for Modified Opinion paragraph.

If there is a material misstatement in the financial statements that relates to narrative disclosures, the auditor gives an explanation of how the disclosures are misstated.

If required disclosures are not made in the financial statements, the auditor is required to follow the following process:

(a) He discusses the non-disclosure with those charged with governance[16].

This could present a practical difficulty if the auditor's report is to be issued on the date of the audit committee meeting itself. The auditor may overcome this by seeking an audio/ video conference call with the audit committee or a one-on-one meeting with its chairperson and discuss the matter well in advance of the scheduled audit committee meeting.

(b) He describes the nature of the omitted information in the Basis for Modified Opinion paragraph, and

(c) Unless prohibited by law/ regulation, he includes the omitted disclosures in his report, provided it is practicable to do so (eg, it may not be practicable if the disclosures are not prepared by the management, or are not otherwise readily available to the auditor, or are far too voluminous to be included in an auditor's report) and he has obtained sufficient appropriate audit evidence about the omitted information.

If the modification is because of his inability to obtain sufficient appropriate audit evidence, the auditor provides the reasons for that inability. In such cases, the auditor should be careful that his explanations in the report about the said inability are his own assertions and not inadvertently an advocacy of the management's representations.

Where an auditor gives a disclaimer or an adverse opinion for a given reason that he explains in the *Basis for Disclaimer of Opinion* or *Basis for Adverse Opinion* paragraph but there are also other matters that would have independently merited a modification, he describes and gives the reasons and effects of those matters as well in the same paragraph.

[16] Wherever possible, communication with Those Charged with Governance should be in writing. Where such communication is done orally, it is advisable for the auditor to document the minutes of the conversation and, unless impracticable, send the minutes to the other party stating that he would presume confirmation unless objection is received. This creates evidence that he fulfilled his duty of communicating with Those Charged with Governance.

Question 41: How is the Modified Opinion paragraph to be given?

Response 41: Where opinion is modified, the paragraph is titled as "*Qualified Opinion*" or "*Adverse Opinion*" or "*Disclaimer of Opinion*" as may be appropriate.

Where the opinion is qualified due to material misstatement in the financial statements, the auditor uses the words: "Except for the effects of the matter(s) described in the Basis for Qualified Opinion paragraph", the financial statements give a true and fair view, etc.

Where the qualification is because of inability to obtain sufficient appropriate audit evidence, the phrase to be used is "Except for the possible effect(s) of matters described in the Basis for Qualified Opinion paragraph", the financial statements give a true and fair view, etc.

Note that use of the words "*Subject to*" that were hitherto being used for qualified opinions so far is discouraged under SA 705 as these words are considered to be not sufficiently clear or forceful.

Where the opinion is a disclaimer of opinion due to inability to obtain sufficient appropriate audit evidence, the auditor states that "*because of the significance of the matter(s) described in the Basis for Disclaimer of Opinion paragraph*", he has "*not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion and, accordingly*", he does "*not express an opinion on the financial statements*."

Where the auditor expresses an adverse opinion under a fair presentation framework he states that "*in his opinion, because of the significance of the matter(s) described in the Basis for Adverse Opinion paragraph, the financial statements do not give a true and fair view in accordance with the applicable financial reporting framework*…."

Where the auditor expresses an adverse opinion under a compliance framework he states that "*in his opinion, because of* *the significance of the matter(s) described in the Basis for Adverse Opinion paragraph, the financial statements have not been prepared, in all material respects, in accordance with the applicable financial reporting framework*…"

Question 42: When a modified opinion is given, does the Auditor's Responsibility paragraph also correspondingly change?

Response 42: Yes. When the auditor gives a qualified opinion, in the last sentence of the Auditor's Responsibility paragraph would state, "*We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion*."

When the auditor gives an adverse opinion, the aforementioned last sentence of the Auditor's Responsibility paragraph would stand modified as follows, '*We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse audit opinion.*"

When the auditor gives a disclaimer of opinion, he states in the Auditor's Responsibility paragraph as follows, "*Our responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with Standards on Auditing issued 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*".

Question 43: What is an auditor obligated to do if he expects to modify his report?

Response 43: If the auditor expects to issue anything other than a clean opinion, he has an obligation to communicate this to those charged with governance (eg, an audit committee or board of directors or partners/ trustees in case of a firm/ trust) that he intends to do so, as well as provide them the proposed wording.

An issue that results in a modification to the audit opinion or which involves including an emphasis or other matter paragraph in the auditor’s report is obviously important enough to require such communication before report issuance. Likewise, those charged with governance too get the opportunity to provide further information and explanations, that hitherto might not have been provided to the auditor by the management, which might lead the auditor to reconsider his earlier decision.

CHAPTER 5
SA 706 EMPHASIS OF MATTER PARAGRAPHS AND OTHER MATTER PARAGRAPHS IN THE INDEPENDENT AUDITOR'S REPORT

Question 44: Does insertion of an emphasis of matter paragraph in the auditor's report make the opinion "modified"?

Response 44: No. In the erstwhile Standard (ie AAS 28), an emphasis of matter paragraph was included under "modified opinion", but SA 705 excludes emphasis of matter paragraphs and other matter paragraphs from being termed as "modifications to the audit opinion". These now form the subject-matter of a new standard, *viz.,* SA 706.

The point to note is that an emphasis of matter is not a part of the audit opinion at all. It is a separate, independent paragraph designed to provide "additional communication" to the users.

Question 45: Why is an "emphasis of matter" paragraph given by an auditor?

Response 45: An extremely important point to note is that an emphasis of matter paragraph deals with matters that are already *appropriately presented or disclosed* in the financial statements. This means that the auditor does not have any reservations about such matters.

It is seen that sometimes auditor's reports contain paragraphs that begin with the words "*Without qualifying our opinion* ….", but the issue then described is one where the auditor has a clear reservation. At times even the words "*without qualifying our opinion*" are not used for a matter that is actually qualificatory in nature but the opinion is not made "*subject to*" that matter, so that it appears as if it is not a qualification. In such cases, where the impact is either material or pervasive, the auditor needs to suitably modify his opinion.

Using an emphasis of matter paragraph where a qualification should be given is clearly a non-compliance with the Standards. Standard on Auditing (SA) 706 specifically states that "*An Emphasis of Matter paragraph is not a substitute for either the auditor expressing a qualified opinion or an adverse opinion, or disclaiming an opinion, when required by the circumstances of a specific audit engagement*."

The question then is, if the matter is already appropriately presented or disclosed, why is it necessary for an auditor to emphasize it in his report?

An emphasis of matter paragraph is defined as "*A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements*."

Question 46: What kind of circumstances may require issuing an emphasis of matter paragraph?

Response 46: Examples given in the Standard itself are:

- An uncertainty relating to the future outcome of an exceptional litigation or regulatory action.

- Early application (where permitted) of a new Accounting Standard that has a pervasive effect on the financial statements in advance of its effective date.

- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

A current topical example could be the likely impact that migration from the existing Indian Accounting Standards to the converged Accounting Standards will have on the financial position and performance of an entity in the coming accounting period where such migration has been notified by law or regulation.

Another example could be the impact, if significant, of an unconventional interpretation of an Accounting Standard that an entity may have taken, even though the auditor is fully in agreement with it.

Question 47: Is it advisable for an auditor to give emphasis of matter paragraphs to highlight all significant matters and transactions that affect the financial statements?

Response 47: No. The SA 706 clearly states that "widespread use of emphasis of matter paragraphs diminishes the importance of the auditor's communication of such matters". An auditor's report is a carefully worded document that should contain only as much information as is required.

When giving an emphasis of matter, care should also be taken to ensure that the auditor does not introduce new fact or information that is not already presented or disclosed in the financial statements. It is because the Standard is clear that "An Emphasis of Matter paragraph is not a substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make."

Question 48: What is an "Other Matter" paragraph, and how is it different from an Emphasis of Matter paragraph?

Response 48: In the erstwhile Standard (ie AAS 28) there was no concept of an Other Matter Paragraph and thus, no distinction between the Emphasis of Matter Paragraph *vis a vis* Other Matters Paragraph. SA 706 draws a distinction between the two.

An Other Matter Paragraph is defined as "A paragraph included in the auditor's report that refers to matters *other than those presented or disclosed in the financial statements* that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report."

In other words, the distinction is that while an Emphasis of Matter Paragraph refers to matters that **are** appropriately presented or disclosed in the financial statements, an Other Matter paragraph refers to matters that are **not** presented or disclosed in the financial statements but the auditor feels the need to bring them to the users' attention.

The other point of difference to note are that while the definition of emphasis of matter paragraph uses the word "*fundamental*" with reference to understanding of the financial statements, the definition of other matter paragraph uses the word "*relevant*". The reason is that *matters of emphasis* are mentioned in the financial statements and are therefore already available to the users. By highlighting them in his report, the auditor specifically points the readers' attention to these matters. It is only the most "fundamentally important" matters that are therefore included in emphasis of matter.

On the other hand, *other matters* are those related to the users' understanding of the audit, the auditor's responsibility or the auditor's report that are not mentioned at all in the financial statements and therefore the users are likely to be unaware of them. So, if the auditor believes that such information is "relevant", he informs the users through his report.

A key point to note is that an Other Matter paragraph is limited to information about the audit, the auditor's responsibility or the auditor's report, and does not include matters related to the financial statements as is the case with the Emphasis of Matter paragraph.

Question 49: If an auditor disagrees with or is uncomfortable about the recognition, measurement, disclosure or presentation of a transaction or event reflected in the financial statements, can he highlight it in an emphasis of matter paragraph?

Response 49: No. It is important to note that Emphasis of Matter is given only in respect of matters that are "appropriately presented or disclosed" in the financial statements. This means that the auditor should and is deemed to agree entirely with the treatment of that matter in the financial statements.

In case he has a reservation, he refers to SA 705 and considers if his reservation merits a modification to the auditor's opinion. If, in terms of the guidance given in SA 705, he concludes that the matter is not worthy of a modification to his opinion, he cannot then use an Emphasis of Matter paragraph to highlight that matter merely because he cannot qualify his opinion.

Question 50: What are the requirements for including an Emphasis of Matter paragraph in the auditor's report?

Response 50: There are four requirements: (a) Emphasis of matter paragraph is given immediately after the opinion paragraph; (b) It has a heading "Emphasis of Matter" (to make its nature very clear to the users); (c) The paragraph must provide a reference to the matter being emphasized and where, in the financial statements, that matter in its elaborated form is to be found; and (d) the paragraph contains a declaration that the auditor's opinion is not modified in respect of the matter emphasized.

Question 51: Is it appropriate to insert an emphasis of matter paragraph also in the section of the auditor's report titled "*Report on Other Legal and Regulatory Requirements*"?

Response 51: An emphasis of matter paragraph is given to draw the uses' attention to a fundamentally important matter that is already appropriately presented or disclosed in the financial statements.

Where the auditor also has reporting obligations under a law or regulation in addition to providing an audit opinion, these obligations would be more or less in the nature of compliance reporting ie where the auditor makes assertions about whether something exists or does not exist or whether something has been done or not. Such reporting would, by and large, be on factual matters, even if it requires exercising the auditor's professional judgement.

In the light of this, it is difficult to visualize a situation where it may be appropriate to give an emphasis of matter paragraph also in the section of the auditor's report titled "Report on Other Legal and Regulatory Requirements".

Question 52: Where is an Other Matter paragraph given in the auditor's report?

Response 52: If the other matter pertains to the audit, the auditor's responsibility or the auditor's report insofar as expressing an opinion on the financial statements is concerned, the other matter paragraph is placed immediately below the opinion paragraph. If there is also an Emphasis of Matter paragraph following the opinion paragraph, then the Other Matter paragraph is placed immediately below the Emphasis of Matter paragraph.

If the Other Matter pertains to audit, the auditor's responsibility or the auditor's report insofar as other reporting responsibilities of the auditor are concerned (eg., reporting responsibilities under CARO, 2003), an other matter paragraph is included in the section of the auditor's report titled: "Report on Other Legal and Regulatory Requirements".

Question 53: What kind of circumstances may require issuing an Other Matter paragraph?

Response 53: An Other Matter paragraph may be required to enhance users' understanding of an audit. For example, assume that a client imposes a major scope limitation after the auditor has, in good faith, accepted the engagement and performed a substantial part of the audit. Paragraphs 11 to 14 of SA 705 deal with this situation and say that in case the possible effects on the financial statements of resulting undetected misstatements is both material and pervasive such that giving a qualified opinion would not be adequate, the auditor should resign from the engagement. Further, assume that the appointment of the auditor is under a law and that law does not permit the auditor once appointed to simply resign. Under these circumstances, the auditor should explain the scope limitation and his inability to resign in an Other Matter paragraph.

An Other Matter paragraph could also be required if it is relevant to users' understanding of the auditor's responsibilities or the auditor's report. For example, the same auditor is engaged to audit financial statements of an entity both under Indian GAAPs and under IFRSs. He issues two separate auditor's reports on the two sets of financial statements, both under the general purpose framework for the same accounting period. In such case, the auditor may include an Other Matter paragraph in the auditor's report, referring to the fact that another set of financial statements has been prepared by the same entity in accordance with another general purpose framework and that the auditor has issued a report on those financial statements.

In another instance, if the financial statements are special purpose financial statements but prepared as per a general purpose framework, an other matter paragraph is the place where the auditor would state that the auditor's report is intended solely for the intended users, and should not be distributed to or used by other parties.

Question 54: What does an Other Matter paragraph not include?

Response 54: An Other Matter Paragraph does not include:

- Any matter that is required to be presented or disclosed in the financial statements – this is because anything to do with such matters falls within the purview of an emphasis of matter paragraph;

- Any information that the auditor is prohibited from providing by law, regulation or other Standards, for example, ethical requirements relating to confidentiality of client information;

- Information that is required to be provided by management – this is because auditors should keep away from trespassing into management's territory in order to retain their independence. The management's and auditor's responsibility paragraphs clearly demarcate what each is responsible for.

Question 55: What is an auditor obligated to do if he expects to include either an Emphasis of Matter Paragraph or an Other Matter Paragraph in his report? (See Question 43 above)

Response 55: If the auditor expects to issue anything other than a clean opinion, he has an obligation to communicate this to those charged with governance (eg, an audit committee or board of directors or partners/ trustees in case of a firm/ trust) that he intends to do so as well as to provide them the proposed wording.

An issue that involves including an emphasis or other matter paragraph in the auditor's report is obviously important enough to require such communication before report issuance. Likewise, those charged with governance too get the opportunity to provide further information and explanations, hitherto not provided to the auditor by the management, which might lead the auditor to reconsider his earlier decision.

Appendix I

ILLUSTRATIVE FORMATS OF AUDITORS' REPORTS ON FINANCIAL STATEMENTS*

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, which is a fair presentation framework.
- The terms of the audit engagement reflect description of management's responsibility for the financial statements in SA 210 (Revised).
- The report is unmodified and does not include either an Emphasis of Matter paragraph or an Other Matter(s) paragraph.
- 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.

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* Reproduced from Appendix to SA 700, "Forming an Opinion and Reporting on Financial Statements".

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.

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. 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 audit opinion.

Opinion

In our opinion and to the best of our information and according to the explanations given to us, 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 Statement of Profit and Loss, 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][17];

    (c) The Balance Sheet, Statement of Profit and Loss, and Cash Flow Statement dealt with by this Report are in

[17] To be included if relevant.

agreement with the books of account [and with the returns received from branches not visited by us][18];

(d) In our opinion, the Balance Sheet, Statement of Profit and Loss, and Cash Flow Statement comply with the Accounting Standards referred to in subsection (3C) of section 211 of the Companies Act, 1956;

(e) 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 Companies Act, 1956.

(f) 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.

For XYZ and Co.
Chartered Accountants
Firm's Registration Number[19]

Signature
(Name of the Member Signing the Audit Report)
(Designation[20])
Membership Number

Place of Signature
Date

[18] To be included if relevant.
[19] See footnote 25.
[20] 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, which is a fair presentation framework.
- The terms of the group audit engagement reflect description of management's responsibility for the financial statements in SA 210 (Revised).
- The report is unmodified and does not include either an Emphasis of Matter paragraph or an Other Matter(s) paragraph.

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of ABC Company Limited

We[21] 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 the 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

[21] As there is no reporting on 'Other Legal and Regulatory Requirements', there is no necessity of including the heading 'Report on the Financial Statements' above the introductory paragraph.

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.

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 judgement, 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. 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 audit opinion.

Opinion

In our opinion and to the best of our information and according to the explanations given to us, the consolidated financial statements 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 Statement of Profit and Loss, 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[22]

Signature
(Name of the Member Signing the Audit Report)
(Designation[23])
Membership Number
Place of Signature
Date

[22] See footnote 25.
[23] Partner or Proprietor, as the case may be.

Illustration 3:

Circumstances include the following:

- Audit of a complete set of separate general purpose financial statements of an entity prepared in accordance with the requirements of XYZ Law of India under a compliance framework.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in SA 210 (Revised).
- The report is unmodified and does not include either an Emphasis of Matter paragraph or an Other Matter(s) paragraph.

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

We[24] have audited the accompanying financial statements of ABC and Associates, which comprise the Balance Sheet as at March 31, 20XX, and the Profit and Loss Account[25] 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 in accordance with XYZ Law of India. This responsibility includes the design, implementation and maintenance

[24] As there is no reporting on 'Other Legal and Regulatory Requirements', there is no necessity of including the heading 'Report on the Financial Statements' above the introductory paragraph.

[25] Provide titles of all financial statements that comprise a full set of financial statements required by XYZ Law of India.

of internal control relevant to the preparation of the financial 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 judgement, 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. 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 audit opinion.

Opinion[26]

In our opinion and to the best of our information and according to the explanations given to us, the financial statements of ABC and Associates for the year ended March 31, 20XX are prepared, in all material respects, in accordance with XYZ Law of India.

[26] Note that the opinion excludes the words 'true and fair' as this report is not under a fair presentation framework.

For XYZ and Co.
Chartered Accountants
Firm's Registration Number[27]

Signature
(Name of the Member Signing the Audit Report)
(Designation[28])
Membership Number
Place of Signature
Date

[27] See footnote 25.
[28] Partner or Proprietor, as the case may be.

Appendix II

ILLUSTRATIVE FORMATS OF AUDITORS' REPORTS WITH MODIFICATIONS TO THE OPINION*

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 (Revised).
- 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.

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* Reproduced from the Appendix to SA 705, "Modifications to the Opinion in the Independent Audtior's Report".

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.

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. 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[29]

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 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.

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 Statement of Profit and Loss, 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

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

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][30];

c. 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][31];

d. 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;

e. 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.

f. 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

[30] To be included if relevant.
[31] To be included if relevant.

such cess is to be paid, no cess is due and payable by the Company.

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

Signature
(Name of the Member Signing the Audit Report)
(Designation[32])
Membership Number
Place of Signature
Date

[32] Partner or Proprietor, as the case may be.

Illustration 5:

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 (Revised).
- 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

We[33] 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

[33] 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.

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.

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. 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.

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 Statement Profit and Loss, 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[34]

Signature
(Name of the Member Signing the Audit Report)
(Designation[35])
Membership Number
Place of Signature
Date

[34] See footnote 13.
[35] Partner or Proprietor, as the case may be.

Illustration 6:

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 (Revised).
- 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.

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. 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.

Qualified Opinion

In our opinion and to the best of our information and according to the explanations given to us, except for the possible effects[36] 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 Statement of Profit and Loss, 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.

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

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 0the purposes of our audit have been received from branches not visited by us][37];

c. 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];

d. Except for the possible effects[39] 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;

e. 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.

f. 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.

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[37] To be included if relevant.

[38] To be included if relevant.

[39] Note the use of words “possible effects” as the auditor was unable to obtain sufficient appropriate audit evidence.

For XYZ and Co.
Chartered Accountants
Firm's Registration Number[40]

Signature
(Name of the Member Signing the Audit Report)
(Designation[41])
Membership Number
Place of Signature
Date

[40] See footnote 13.
[41] Partner or Proprietor, as the case may be.

Illustration 7:

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 (Revised).

- 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.

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 effects[42] 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][43];

c. 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][44];

d. 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;

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

[43] To be included if relevant.

[44] To be included if relevant.

e. 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.

f. 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.

For XYZ and Co.
Chartered Accountants
Firm's Registration Number[45]

Signature
(Name of the Member Signing the Audit Report)
(Designation[46])
Membership Number
Place of Signature
Date

[45] See footnote 13.
[46] Partner or Proprietor, as the case may be.

Illustration 8:

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 (Revised).

- 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.

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:

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 effects[47] 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][48];

c. 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][49];

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

[48] To be included if relevant.

[49] To be included if relevant.

d. 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;

e. 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.

f. 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.

For XYZ and Co.
Chartered Accountants
Firm's Registration Number[50]

Signature
(Name of the Member Signing the Audit Report)
(Designation[51])
Membership Number
Place of Signature
Date

[50] See footnote 13.
[51] Partner or Proprietor, as the case may be.

ILLUSTRATIVE FORMATS OF AN AUDITOR'S REPORT THAT INCLUDES AN EMPHASIS OF MATTER PARAGRAPH/OTHER MATTER PARAGRAPH*

Illustration 9:

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 (Revised).
- 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.
- There is uncertainty relating to a pending exceptional litigation matter. This is highlighted in the auditor's report by an Emphasis of Matter paragraph.
- 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

* Reproduced from the Appendix to SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report".

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.

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 judgement, 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. 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

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 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.

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 Statement of Profit and Loss, 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.

Emphasis of Matter

We draw attention to Note X to the financial statements which describes the uncertainty[52] related to the outcome of the lawsuit filed against the Company by XYZ Company. Our opinion is not qualified in respect of this matter.

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 under provisions of 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;

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][53];

c. 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][54];

d. Except for 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 subsection (3C) of section 211 of the Act;

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[52] In highlighting the uncertainty, the auditor uses the same terminology that is used in the note to the financial statements.

[53] To be included if relevant.

[54] To be included if relevant.

e. 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.

f. 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.

For XYZ and Co.
Chartered Accountants
Firm's Registration Number[55]

Signature
(Name of the Member Signing the Audit Report)
(Designation[56])
Membership Number
Place of Signature
Date

[55] The attention of the members is drawn to the decision relating to inclusion of the firm's registration number in the audit report, taken by the Council of the Institute of Chartered Accountants of India at its 292nd meeting held on January 13, 2010 and the related Announcement is published in February 2010 issue of the Journal.

[56] Partner or Proprietor, as the case may be.

Illustration 10:

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, which is a fair presentation framework.
- The terms of the group audit engagement reflect description of management's responsibility for the financial statements in SA 210 (Revised).
- The report includes an Other Matter paragraph in respect of the auditor's responsibility in respect of subsidiaries not audited by him but which form part of the consolidated financial statements under report.

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of ABC Company Limited

We[57] 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

[57] As there is no reporting on 'Other Legal and Regulatory Requirements', there is no necessity of including the heading 'Report on the Financial Statements' above the introductory paragraph.

financial position, consolidated financial performance and consolidated cash flows of the Company in accordance with accounting principles generally accepted in India; this 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.

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. 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 audit opinion.

Opinion

In our opinion and to the best of our information and according to the explanations given to us and based on the consideration of the reports of the other auditors on the financial statements of the subsidiaries as noted below, the consolidated financial statements 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 Statement of Profit and Loss, 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.

Other Matter[58]

We did not audit the financial statements of certain subsidiaries, whose financial statements reflect total assets (net) of Rs. XXXX as at March 31, 20XX, total revenues of Rs. XXXX and net cash outflows amounting to Rs. XXXX for the year then ended. These financial statements have been audited by other auditors whose reports have been furnished to us by the Management, and our opinion is based solely on the reports of the other auditors. Our opinion is not qualified in respect of this matter.

For XYZ and Co.
Chartered Accountants
Firm's Registration Number[59]

Signature
(Name of the Member Signing the Audit Report)
(Designation[60])
Membership Number
Place of Signature
Date

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[58] This matter is given in "Other Matter" paragraph as it is currently permitted in India for an auditor to sign off a consolidated audit opinion, even where he has not performed a substantial part of the audit himself.
[59] See footnote 9.
[60] Partner or Proprietor, as the case may be.

Appendix IV

ILLUSTRATIVE QUALIFIED OPINION PARAGRAPHS

Illustration 1:

Basis for Qualified Opinion

As more fully explained in the note X of Schedule XX to the financial statements, the Company has not accrued interest in respect of outstanding inter corporate deposits of Rs xxx million which as at March 31, 20XX amounts to Rs. xx million. Had this interest been accrued the net loss for the year would have been Rs xx million as against the reported net loss of Rs xx million), accumulated losses as at March 31, 20XX would have been Rs xx million as against the reported figure of Rs xx million, and current liabilities as at March 31, 20XX would have been Rs xx million as against the reported figure of Rs xx million.

Qualified Opinion

In our opinion, *except for the effects of the matter described in the Basis for Qualified Opinion paragraph,* the financial statements give a true and fair view of the financial position of ABC Company as at March 31, 20XX, and of its financial performance and its cash flows for the year then ended in accordance with the accounting standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956.

Illustration 2:

Basis for Qualified Opinion

As detailed in Note XXX to the financial statements, pursuant to the Scheme of Arrangement, PQR Inc., USA, a wholly owned subsidiary of the Company whose financial statements reflect total assets of Rs xx cr (US$ xx converted at US$ 1 = Rs 45) as at March 31, 20XX was merged with the Company on the basis of unaudited financial statements which have not been verified by us.

Qualified Opinion

In our opinion, *except for the effects of the matter described in the Basis for Qualified Opinion paragraph*, the financial statements give a true and fair view of the financial position of ABC Company as at March 31, 20XX, and of its financial performance and its cash flows for the year then ended in accordance with the accounting standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956.

Illustration 3:

Basis for Qualified Opinion

As stated in Note XX, Schedule XX the Company has paid Rs XX lakhs as remuneration to managing and other directors, which is in excess of the limits prescribed under the Companies Act, 1956. Had the Company accounted for the remuneration in accordance with law, the loss after tax for the year would have been lower and loans and advances would have been higher by Rs XX lakhs.

Qualified Opinion

In our opinion, *except for the effects of the matter described in the Basis for Qualified Opinion paragraph,* the financial statements give a true and fair view of the financial position of ABC Company as at March 31, 20XX, and of its financial performance and its cash flows for the year then ended in accordance with the accounting standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956.

Illustration 4:

Basis for Qualified Opinion

In respect of performance defaults made by the Company during the year in complying with XYZ Act the competent authority under the said Act has levied compensation, interest and penalty aggregating to Rs xxx cr on the Company. The Company has *neither contested nor provided for this liability in the financial statements. Had this liability been accounted, the Company's profit before tax would have been lower by Rs xxx cr, its current tax expense lower by Rs xxx cr, its current liabilities higher by Rs xxx and reserves and surplus lower by Rs xxx cr.*

Qualified Opinion

In our opinion, *except for the effects of the matter described in the Basis for Qualified Opinion paragraph,* the financial statements give a true and fair view of the financial position of ABC Company as at March 31, 20XX, and of its financial performance and its cash flows for the year then ended in accordance with the accounting standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956.

Report on Other Legal and Regulatory Requirements

(*c*) *Except for the effects of the matter described in the Basis for Qualified Opinion paragraph,* 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;

(*d*) *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;

Illustration 5:

Basis for Qualified Opinion

As stated in note (x) of Schedule XX to the financial statements, for recognizing profit on contracts, stage of completion is determined as a proportion that contract costs incurred for the work performed upto the closing date bear to the estimated total costs. Further, as stated in that note, expected loss on contracts is recognized when it is probable that the total contract costs will exceed the total contract revenue. For this purpose, total contract costs are *ascertained on the basis of contract costs incurred and cost to completion of contracts which is arrived at by the management based on current technical data, forecast and estimate of net expenditure to be incurred in future including for contingencies etc., which being technical matters have been relied on by us. Revisions in projected profit/loss arising from change in estimate etc., are reflected during the course of work in each accounting period in which the revisions have been made. The effect of these revisions has not been disclosed separately in the accounts, as the amounts thereof cannot be accurately determined.*

Qualified Opinion

In our opinion, *except for the effects of the matter described in the Basis for Qualified Opinion paragraph,* the financial statements give a true and fair view of the financial position of ABC Company as at March 31, 20XX, and of its financial performance and its cash flows for the year then ended in accordance with the accounting standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956.

Illustration 6:

Bases for Qualified Opinion

(a) Under the provisions of the Finance Act, 1994 relating to Service Tax read with the Notification No.15/2005 - Service Tax dated 7/06/2005, any service provided or to be provided to its members by any Club for a subscription or any other amount is taxable. Accordingly, entrance fees received from the members are liable to service tax. However, no service tax has been collected or paid by the Club for the period upto XXth December, 20XX on entrance fees received from the members. Had service tax of Rs. XXX been provided for on the entrance fees referred to above, the General Reserve as at 30th June, 20X1 would have been lower by Rs. XXX and the General Reserve as at 30th June, 20XX would have been lower by Rs. XXX and Current Liabilities as at 30th June, 20X1 would have been higher by Rs. XXX and Current Liabilities as at 30th June, 20XX would have been higher by Rs. XXX.

(b) *As stated in Note xx of Schedule "C" to the financial statements, the Club has accrued Commitment Fee of Rs.XXX in respect of sponsorship by PQR Limited of the TTT Event. Since the agreement referred to in the aforesaid Note does not provide for entitlement of the Club to the Commitment Fee irrespective of the cancellation of the agreement or non happening of the event, in our opinion Rs.XXX should not have been accounted in the Income and Expenditure Account. As a result, the Excess of Income over Expenditure for the year ended 30th June, 20X1 is overstated by Rs. XXX, the General reserve as at 30th June, 20X1 is overstated by Rs. XXX and Current Liabilities as at 30th June, 20X1are understated by Rs. XXX.*

Qualified Opinion

In our opinion, *except for the effects of the matters described in the Bases for Qualified Opinion paragraph,* the financial statements give a true and fair view of the financial position of ABC Club as at June 30, 20X1, and of its financial performance for the year then ended in accordance with the accounting standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956.

Illustration 7:

Bases for Qualified Opinion

(a) *As stated in Note B-3 of Schedule X to the financial statements, no provision has been made for penalty that may be payable under section 598 of the Companies Act 1956 for non-compliance with the provisions of the Act as the amount cannot be ascertained.*

(b) *The confirmation from Head Office for the balance of Rs XXX as at March 31, 20X1 (Rs XXX as at March 31, 20XX) was not available for our verification. Accordingly, we are unable to comment on the balance in Head Office Account as at the year-end and the consequential effect, if any, on the expenses incurred for the year and/or on the assets/ liabilities of the Liaison Office.*

Qualified Opinion

In our opinion, *except for the effects of the matters described in the Bases for Qualified Opinion paragraph,* the financial statements give a true and fair view of the financial position of ABC Limited as at June 30, 20X1, and of its financial performance for the year then ended in accordance with the accounting standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956.

Illustration 8:

Bases for Qualified Opinion

1. *According to the information and explanations given to us, in the opinion of the management there is no need of any provision to be made for impairment of its intangible assets (namely goodwill and customer relationships) which are being carried in the books at a written down value of Rs. XXX (Previous year Rs.XXX). Refer Note no. XX of Schedule Q, Part III. However we have not been able to corroborate the Management's contention that there is no need for any provision for impairment loss in respect of these intangible assets. Accordingly we are unable to comment on the necessity or otherwise to provide for an impairment loss in respect of these intangible assets. The effect of the non-provision of the impairment loss on assets, if any, cannot be quantified. A similar qualification had been given in the previous year's auditor's report.*

2. *As stated in note no. XX of Schedule Q, Part III, balances outstanding (net amount receivable Rs.XXX) in respect of PQR India Pvt. Ltd, are subject to confirmation and reconciliation, if any.*

Qualified Opinion

In our opinion, *except for the effects of the matters described in the Bases for Qualified Opinion paragraph,* the financial statements give a true and fair view of the financial position of ABC Limited as at March 31, 20XX, and of its financial performance for the year then ended in accordance with the accounting standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956

Illustration 9:

Basis for Qualified Opinion

We draw attention to note X of schedule XX of the financial statements wherein the management has explained its reasons for preparing the financial statements on a going concern basis. As at 30 September 20XX, the current liabilities exceed its current assets by Rs. XXX and the entity has incurred cash loss amounting to Rs. XXX during the period. These factors raise substantial doubt as to the Company's ability to continue as going concern and therefore, may not be able to realise its assets and discharge its liabilities in the normal course of business. The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts and classification of liabilities that may be necessary if the Company is unable to continue as a going concern.

Qualified Opinion

In our opinion, *except for the effects of the matters described in the Basis for Qualified Opinion paragraph,* the financial statements give a true and fair view of the financial position of ABC Limited as at March 31, 20XX, and of its financial performance for the year then ended in accordance with the accounting standards referred to in sub-section (3C) of section 211 of the Companies Act, 1956.

Illustration 10:

Basis for Qualified Opinion

As stated in Note XX to the financial results, as per the policy followed by the Company for preparation of quarterly results, the sugar off-season expenditures amounting to Rs. XXX lacs and Rs. XXX lacs for the quarter and half year ended September 30, 20X0 respectively have been deferred for inclusion in the cost of *sugar to be produced in the remaining part of the financial year. Had the Company charged expenditure so incurred to the accounting period in which such expenses were incurred, the decrease in stock in trade would have been higher by Rs. XXX lacs and Rs. XXX lacs for the quarter and half year ended September 30, 2010 respectively, and loss after tax would have been higher by Rs. XXX lacs and Rs. XXX lacs for the quarter and half year ended September 30, 20X0 respectively.*

Qualified Opinion

In our opinion, except for the matters referred to in the *Basis for Qualified Opinion paragraph*, nothing has come to our attention that causes us to believe that the accompanying Statement prepared in accordance with the Accounting Standards referred to in Section 211 (3C) of the Companies Act, 1956 and other recognised accounting practices and policies has not disclosed the information required to be disclosed in terms of Clause 41 of the Listing Agreement with the stock exchange, including the manner in which it is to be disclosed, or that it contains any material misstatement.

Illustration 11:

Basis for Qualified Opinion

The Company has not accounted for excise duty demands aggregating to Rs.XXX raised against it during the quarter ended 30 September 20X0, for which it is in the process of examining the merits of the claims and seeking legal advice in order to consider filing appeals with appellate authorities.

Qualified Opinion

Based on our review conducted as stated above in paragraph 2, nothing has come to our attention other than the possible effect of the matter referred to in *the Basis for Qualified Opinion paragraph*, that causes us to believe that the accompanying Statement, prepared in accordance with the Accounting Standards referred to in Section 211 (3C) of the Companies Act, 1956 and other recognised accounting practices and policies, has not disclosed the information required to be disclosed in terms of Clause 41 of the Listing Agreements with the stock exchanges, including the manner in which it is to be disclosed, or that it contains any material misstatement.

ILLUSTRATIVE EMPHASIS OF MATTER PARAGRAPHS

Illustration 12:

Emphasis of Matter

We draw attention to Note X(i) and X(ii) to the financial statements which describe the execution application filed in the H'ble Bombay High Court by aggrieved selling shareholders of the acquired entity against the deduction made by the Company from deferred purchase consideration in respect of payments it had to make to the Income Tax authorities in respect of demands against the acquired company for periods prior to acquisition, and the execution proceedings initiated by the Company against the selling shareholders for recovery of amounts due to it pursuant to the selling shareholders' obligation to indemnify the Company against tax demands raised on the acquired entity for years prior to the effective date of acquisition. Our opinion is not qualified in respect of this matter.

Illustration 13:

Emphasis of Matter

We draw attention to Note XX to in Schedule XX of the financial statements which provides details with regard to the identification and adjustment during the year of the amount of impairment of fixed assets amounting to Rs. xx cr (net of tax) and certain expenses amounting to Rs. xx cr against Business Reconstruction Reserve. This reserve was created under the Scheme of Arrangement u/s

391 to 394 of the Companies Act 1956 approved by the Honourable High Court of Mumbai vide its Order dated XXth June, 20XX by transferring the balance standing to the credit of its Securities Premium Account for adjusting certain expenses as defined in the Scheme. Our opinion is not qualified in respect of this matter.

Illustration 14:

Emphasis of Matter

1. We draw attention to Note XX in Schedule XX of the financial statements relating to exercise of option by the Company to recognise gains and losses arising on fluctuation of foreign exchange rates on long term monetary items, to assets or to a reserve as detailed in the Note, consequent to the amendment to Accounting Standard 11, "The Effects of Changes in Foreign Exchange Rates", resulting in the profits for the year being higher by Rs xxx million and its consequential impact on the reserves and surplus and carrying cost of assets as detailed therein.

2. We further draw attention to Note YY in Schedule XX of the financial statements relating to change in method of recognizing the impact of foreign currency fluctuations on effective hedging instruments in accordance with principles of hedge accounting set out in Accounting Standard 30, "Financial Instruments – Recognition and Measurement", having no impact on the profits for the year.

Our opinion is not qualified in respect of these matters.

Illustration 15:

Emphasis of Matter

We draw attention to Note XX of Schedule XX to the financial statements stating that the Company has paid Rs xx cr under protest against claims of Rs xx cr for expenses which the Company has disputed in matters that are in various stages of litigation. Pending resolution of these disputes by the relevant courts, these expenses have been accounted for in the financial statements based on the management's expectation of the amounts due. Our opinion is not qualified in respect of this matter.

Illustration 16:

Emphasis of Matter

We invite attention to Note No. X of Schedule XX – Notes to the Financial Statements, regarding impairment of fixed assets wherein, due to the highly technical nature of the plant and machinery, we have relied on the estimates and assumptions made by the Company's internal technical department which we *prima facie* found to be reasonable in arriving at the recoverable value of the fixed assets at the Bhandup cash generating unit of the Company. Our opinion is not qualified in respect of this matter.

Illustration 17:

Emphasis of Matter

We draw attention to Note No. X of schedule XX to the financial statements regarding approval of the Central Government in respect of certain transactions for the rendering of services to the parties covered under Section 297 of the Companies Act, 1956 for the period up to December 31, 20XX, which the Company has applied for and is pending approval from the authorities. Our opinion is not qualified in respect of this matter.

Illustration 18:

Emphasis of Matter

In view of their technical nature, we have placed reliance on technical/ commercial evaluation by the management in respect of categorization of wells as exploratory, development and producing, allocation of cost incurred on them, depletion of producing properties on the basis of the proved developed hydrocarbon reserves, liability for abandonment costs, liabilities under NELP for under-performance against agreed Minimum Work Programme and allocation of depreciation on process platforms to transportation and facilities. Our opinion is not qualified in respect of this matter.

Illustration 19:

Emphasis of Matter

Refer note no X of Notes to the Financial Statements in Schedule XX regarding the Scheme of Demerged Undertaking. The Company took over the demerged undertaking of PQR Ltd. under the Composite Scheme of Arrangement sanctioned by the Hon'ble High Court of Gujarat by Order dated 1st March, 20XX. The appointed date for this purpose was 1st December, 20XX and the effective date is 7th March, 20XX. Three parties have filed an appeal against this Order before the Division Bench of the Hon'ble High Court of Gujarat and their appeal, which has been admitted, is pending. The Company has given effect to the above Scheme subject to the Hon'ble High Court's decision in the said appeal. Our opinion is not qualified in respect of this matter.

Illustration 20:

Emphasis of Matter

We draw attention to Note X in Annexure II to the abridged financial statements and also Note XX in Schedule 'M' to the complete set of financial statements regarding deductions made/ amounts withheld by some customers aggregating to Rs. 605,083 thousand (Previous year Rs. 461,224 thousand) on various accounts which are being carried as sundry debtors. The Company is also carrying accrued income of Rs. 95,455 thousand (Previous year Rs. 95,455 thousand) relating to these customers. The ultimate outcome of the above matters cannot presently be determined although the Company is of the view that such amounts are recoverable and hence no provision is required thereagainst. Our opinion is not qualified in respect of this matter.

Illustration 21:

Emphasis of Matter

We draw attention to Note XX of Schedule XXB to the financial statements regarding non-disclosure of the impact of fair value method of accounting on net results and Earnings Per Share as required by the Guidance Note on accounting for employee share-based payments issued by the Institute of Chartered Accountants of India. Our opinion is not qualified in respect of this matter.

Illustration 22:

Emphasis of Matter

We draw attention to: (a) Note 5 on the Statement, which explains the circumstances under which no obligation under a Share Purchase agreement has yet arisen in terms of Accounting Standard 29, in relation to the sale of investments of equity shares in XYZ Limited made during the previous year ended 31st March, 20X0; and (b) Note 4 on the Statement regarding provision made for diminution, other than temporary, in value of investments, which is considered to be adequate for the reasons stated in the said Note. Our opinion is not qualified in respect of these matters

Illustration 23:

Emphasis of Matter

We draw attention to Note 6 to the Consolidated Financial Statements regarding investments in certain subsidiaries aggregating Rs. XXX lacs which are yet to break even. At reporting date, the Company’s share of cumulative losses in these subsidiaries is Rs.XXX lacs against which provision for diminution of Rs. XXX lacs is considered as adequate by the management, based on business plans. Our opinion is not qualified in respect of this matter.

Illustration 24:

Emphasis of Matter

(a) We draw attention to Note No. XX of Schedule YY regarding debit to Goodwill of the loss arising on transfer of the Export Business Undertaking to ABC Private Limited and adjusting such Goodwill against the balance in the Securities Premium Account in terms of the Scheme of Arrangement as approved by the High Court of Bombay. Had such loss not been adjusted against Securities Premium Account as permitted under the Order of the High Court but debited to the Profit and Loss Account as per the generally accepted accounting principles, the net loss before tax of Rs. XXX would have resulted into a net loss before tax of Rs. XXX and the loss carried to Balance Sheet would have been Rs XXX in stead of Rs XXX.

(b) We also draw attention to Note No. CC of Schedule YY regarding investments in a wholly owned subsidiary whose net worth is eroded and the consequent possibility of impairment of the equity investment of Rs XXX made and non-recovery or partial recovery loan of Rs XXX given to it by the Company. For reasons explained in the said Note, including the subsidiary's future business plans and growth prospects, such impairment if any is considered to be temporary in nature and no provision is considered necessary in the accounts of the Company.

Our opinion is not qualified in respect of these matters

Illustration 25:

Emphasis of Matter

We invite attention to Note no. X of Schedule XX-X of the financial statements regarding the cancellation of investment in XXX equity shares of ABC Limited aggregating Rs XXX and the issuance of XXX transferable warrants to the Company, both pursuant to a court approved composite scheme of 'Reduction cum Arrangement' between ABC Limited and its shareholders (including the Company).

As stated in the Note, the Company has obtained independent legal counsel's opinion that no tax liability arises on the reduction cum arrangement. On that basis, no tax liability is recognised in respect thereof. Our opinion is not qualified in respect of this matter.

ILLUSTRATIVE DISCLAIMER OF OPINION PARAGRAPH

Illustration 26:

Bases for Disclaimer of Opinion

(a) We have not been able to obtain sufficient appropriate audit evidence with regard to the recoverability of Sundry Debtors, particularly having regard to: (i) the aggregate amount of debtors outstanding for a period exceeding six months being Rs. XXX (ii) debtors in respect of sales during the period aggregating Rs. XXX being fully unrecovered, and (iii) the debtors outstanding at the commencement of the financial year aggregating Rs. XXX being yet to be recovered to the extent of Rs. XXX.

(b) There was also a limitation of scope on the audit carried out by us since while observing the physical verification of stock-in-trade carried out by the Management during the period, individual items aggregating Rs. XXX per the books of account were not produced to us for physical verification. Accordingly, we were precluded from fully performing our audit procedures in this regard.

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.