



INTERNATIONAL STANDARD ON AUDITING (NEW ZEALAND) 705

Modifications to the Opinion in the Independent Auditor's Report (ISA (NZ) 705)

Issued July 2011

Effective for audits of historical financial statements for periods beginning on or after 1 September, 2011.

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INTERNATIONAL STANDARD ON AUDITING (NEW ZEALAND) 705

MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT

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International Standard on Auditing (New Zealand) (ISA (NZ)) 705, "Modifications to the Opinion in the Independent Auditor's Report" should be read in conjunction with ISA (NZ) 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (New Zealand)."

History of Amendments

Table of pronouncements – ISA (NZ) 705 *Modifications to the Opinion in the Independent Auditor's Report*

This table lists the pronouncements establishing and amending ISA (NZ) 705.

Pronouncements	Date approved	Early operative date	Effective date
International Standard on Auditing (New Zealand) 705	July 2011	-	This ISA (NZ) is effective for audits of historical financial statements for periods beginning on or after 1 September, 2011.

Introduction

Scope of this ISA (NZ)

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

Types of Modified Opinions

2. This ISA (NZ) establishes three types of modified opinions, namely, a qualified opinion, an adverse opinion, and a disclaimer of opinion. The decision regarding which type of modified opinion is appropriate depends upon: (Ref: Para. A1)
 - (a) The nature of the matter giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated; and
 - (b) The auditor's judgement about the pervasiveness of the effects or possible effects of the matter on the financial statements.

Effective Date

3. This ISA (NZ) is effective for audits of financial statements for periods beginning on or after 1 September, 2011.

Objective

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

Definitions

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

¹ ISA (NZ) 700, "Forming an Opinion and Reporting on Financial Statements."

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

Requirements

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

6. The auditor shall modify the opinion in the auditor's report when:
 - (a) The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or (Ref: Para. A2-A7)
 - (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement. (Ref: Para. A8-A12)

Determining the Type of Modification to the Auditor's Opinion

Qualified Opinion

7. The auditor shall express a qualified opinion when:
 - (a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or
 - (b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

Adverse Opinion

8. The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

Disclaimer of Opinion

9. The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.
10. The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Limitation Imposed by Management or Those Charged with Governance after the Auditor Has Accepted the Engagement

11. If, after accepting the engagement, the auditor becomes aware that management or those charged with governance have imposed a limitation on the scope of the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor shall request that the limitation be removed.
12. If management or those charged with governance refuse to remove the limitation referred to in paragraph 11, the auditor shall determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence.
13. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall determine the implications as follows:
 - (a) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor shall qualify the opinion; or
 - (b) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall: (Ref: Para. A13-A14)
 - (i) Withdraw from the audit, where practicable and possible under applicable law or regulation; or
 - (ii) If withdrawal from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial statements.
14. If the auditor withdraws as contemplated by paragraph 13(b)(i), before withdrawing, the auditor shall communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion. (Ref: Para. A15)

Other Considerations Relating to an Adverse Opinion or Disclaimer of Opinion

15. When the auditor considers it necessary to express an adverse opinion or disclaim an opinion on the financial statements as a whole, the auditor's report shall not also include an unmodified opinion with respect to the same financial reporting framework on a single financial statement or one or more specific elements, accounts or items of a financial statement. To include such an unmodified opinion in the same report² in these circumstances would contradict the auditor's adverse opinion or disclaimer of opinion on the financial statements as a whole. (Ref: Para. A16)

² ISA (NZ) 805, "Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement" deals with circumstances where the auditor is engaged to express a separate opinion on one or more specific elements, accounts or items of a financial statement.

Form and Content of the Auditor's Report When the Opinion Is Modified*Basis for Modification Paragraph*

16. When the auditor modifies the opinion on the financial statements, the auditor shall, in addition to the specific elements required by ISA (NZ) 700, include a paragraph in the auditor's report that provides a description of the matter giving rise to the modification. The auditor shall place this paragraph immediately before the opinion paragraph in the auditor's report and use the heading "Basis for Qualified Opinion," "Basis for Adverse Opinion," or "Basis for Disclaimer of Opinion," as appropriate. (Ref: Para. A17)
17. If there is a material misstatement of the financial statements that relates to specific amounts in the financial statements (including quantitative disclosures), the auditor shall include in the basis for modification paragraph a description and quantification of the financial effects of the misstatement, unless impracticable. If it is not practicable to quantify the financial effects, the auditor shall so state in the basis for modification paragraph. (Ref: Para. A18)
18. If there is a material misstatement of the financial statements that relates to narrative disclosures, the auditor shall include in the basis for modification paragraph an explanation of how the disclosures are misstated.
19. If there is a material misstatement of the financial statements that relates to the non-disclosure of information required to be disclosed, the auditor shall:
 - (a) Discuss the non-disclosure with those charged with governance;
 - (b) Describe in the basis for modification paragraph the nature of the omitted information; and,
 - (c) Unless prohibited by law or regulation, include the omitted disclosures, provided it is practicable to do so and the auditor has obtained sufficient appropriate audit evidence about the omitted information. (Ref: Para. A19)
20. If the modification results from an inability to obtain sufficient appropriate audit evidence, the auditor shall include in the basis for modification paragraph the reasons for that inability.
21. Even if the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements, the auditor shall describe in the basis for modification paragraph the reasons for any other matters of which the auditor is aware that would have required a modification to the opinion, and the effects thereof. (Ref: Para. A20)

Opinion Paragraph

22. When the auditor modifies the audit opinion, the auditor shall use the heading "Qualified Opinion," "Adverse Opinion," or "Disclaimer of Opinion," as appropriate, for the opinion paragraph. (Ref: Para. A21, A23-A24)
23. When the auditor expresses a qualified opinion due to a material misstatement in the financial statements, the auditor shall state in the opinion paragraph that, in the auditor's opinion, except for the effects of the matter(s) described in the Basis for Qualified Opinion paragraph:

- (a) The financial statements present fairly, in all material respects (or give a true and fair view of ...) in accordance with the applicable financial reporting framework when reporting in accordance with a fair presentation framework; or
- (b) The financial statements have been prepared, in all material respects, in accordance with the applicable financial framework when reporting in accordance with a compliance framework.

When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor shall use the corresponding phrase “except for the possible effects of the matter(s) ...” for the modified opinion. (Ref: Para. A22)

24. When the auditor expresses an adverse opinion, the auditor shall state in the opinion paragraph that, in the auditor’s opinion, because of the significance of the matter(s) described in the Basis for Adverse Opinion paragraph:
- (a) The financial statements do not present fairly (or give a true and fair view of ...) in accordance with the applicable financial reporting framework when reporting in accordance with a fair presentation framework; or
 - (b) The financial statements have not been prepared, in all material respects, in accordance with the applicable financial reporting framework when reporting in accordance with a compliance framework.
25. When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor shall state in the opinion paragraph that:
- (a) Because of the significance of the matter(s) described in the Basis for Disclaimer of Opinion paragraph, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion; and, accordingly,
 - (b) The auditor does not express an opinion on the financial statements.

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

26. When the auditor expresses a qualified or adverse opinion, the auditor shall amend the description of the auditor’s responsibility to state that the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor’s modified audit opinion.

Description of Auditor’s Responsibility When the Auditor Disclaims an Opinion

27. When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor shall amend the introductory paragraph of the auditor’s report to state that the auditor was engaged to audit the financial statements. The auditor shall also amend the description of the auditor’s responsibility and the description of the scope of the audit to state only the following: “Our responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with International Standards on Auditing (New Zealand). 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.”

NZ 27.1 Where the audit engagement is subject to the requirements of the Financial Reporting Act 1993, the audit report is required to state the work done by the auditor and the scope and limitations of the audit.³ Therefore, in the situation described in paragraph 27, the auditor shall include in the Basis for Disclaimer of Opinion paragraph details outlining the work done and the scope and limitation of the audit. Illustrations 4 to 6 give examples of wording to meet this requirement.

Communication with Those Charged with Governance

28. When the auditor expects to modify the opinion in the auditor's report, the auditor shall communicate with those charged with governance the circumstances that led to the expected modification and the proposed wording of the modification. (Ref: Para. A25)

Application and Other Explanatory Material

Types of Modified Opinions (Ref: Para. 2)

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

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

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

A2. ISA (NZ) 700 requires the auditor, in order to form an opinion on the financial statements, to conclude as to whether reasonable assurance has been obtained about whether the financial statements as a whole are free from material misstatement.⁴ This conclusion takes into account the auditor's evaluation of uncorrected misstatements, if any, on the financial statements in accordance with ISA (NZ) 450.⁵

A3. ISA (NZ) 450 defines a misstatement as a difference between the amount, classification, presentation, or disclosure of a reported financial statement item and

³ Financial Reporting Act 1993, sections 16 (1) (a) and (b) – reporting entities; and sections 17 (1) (a) and (b) – exempt companies.

⁴ ISA (NZ) 700, paragraph 11.

⁵ ISA (NZ) 450, "Evaluation of Misstatements Identified during the Audit," paragraph 11.

the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Accordingly, a material misstatement of the financial statements may arise in relation to:

- (a) The appropriateness of the selected accounting policies;
- (b) The application of the selected accounting policies; or
- (c) The appropriateness or adequacy of disclosures in the financial statements.

Appropriateness of the Selected Accounting Policies

A4. In relation to the appropriateness of the accounting policies selected, material misstatements of the financial statements may arise when:

- (a) The selected accounting policies are not consistent with the applicable financial reporting framework; or
- (b) The financial statements, including the related notes, do not represent the underlying transactions and events in a manner that achieves fair presentation.

A5. Financial reporting frameworks often contain requirements for the accounting for, and disclosure of, changes in accounting policies. Where the entity has changed its selection of significant accounting policies, a material misstatement of the financial statements may arise when the entity has not complied with these requirements.

Application of the Selected Accounting Policies

A6. In relation to the application of the selected accounting policies, material misstatements of the financial statements may arise:

- (a) When the selected accounting policies have not been applied consistently with the financial reporting framework, including when selected accounting policies have not been applied consistently between periods or to similar transactions and events (consistency in application); or
- (b) Due to the method of application of the selected accounting policies (such as an unintentional error in application).

Appropriateness or Adequacy of Disclosures in the Financial Statements

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

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

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

A8. The auditor's inability to obtain sufficient appropriate audit evidence (also referred to as a limitation on the scope of the audit) may arise from:

- (a) Circumstances beyond the control of the entity;

- (b) Circumstances relating to the nature or timing of the auditor's work; or
- (c) Limitations imposed by management or those charged with governance.

A9. An inability to perform a specific procedure does not constitute a limitation on the scope of the audit if the auditor is able to obtain sufficient appropriate audit evidence by performing alternative procedures. If this is not possible, the requirements of paragraphs 7(b) and 10 apply as appropriate. Limitations imposed by management or those charged with governance may have other implications for the audit, such as for the auditor's assessment of fraud risks and consideration of engagement continuance.

A10. Examples of circumstances beyond the control of the entity include when:

- The entity's accounting records have been destroyed.
- The accounting records of a significant component have been seized indefinitely by governmental authorities.

A11. Examples of circumstances relating to the nature or timing of the auditor's work include when:

- The entity is required to use the equity method of accounting for an associated entity, and the auditor is unable to obtain sufficient appropriate audit evidence about the latter's financial information to evaluate whether the equity method has been appropriately applied.
- The timing of the auditor's appointment is such that the auditor is unable to observe the counting of the physical inventories.
- The auditor determines that performing substantive procedures alone is not sufficient, but the entity's controls are not effective.

A12. Examples of an inability to obtain sufficient appropriate audit evidence arising from a limitation on the scope of the audit imposed by management or those charged with governance include when:

- Management prevents the auditor from observing the counting of the physical inventory.
- Management prevents the auditor from requesting external confirmation of specific account balances.

Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Limitation Imposed by Management or Those Charged with Governance after the Auditor Has Accepted the Engagement (Ref: Para. 13(b)-14)

A13. The practicality of withdrawing from the audit may depend on the stage of completion of the engagement at the time the scope limitation is imposed. If the auditor has substantially completed the audit, the auditor may decide to complete the audit to the extent possible, disclaim an opinion and explain the scope limitation in the Basis for Disclaimer of Opinion paragraph prior to withdrawing.

A14. In certain circumstances, withdrawal from the audit may not be possible if the auditor is required by law or regulation to continue the audit engagement. This may be the case for an auditor that is appointed to audit the financial statements of public sector entities. It may also be the case in jurisdictions where the auditor is appointed to audit the financial statements covering a specific period, or appointed for a specific period

and is prohibited from withdrawing before the completion of the audit of those financial statements or before the end of that period, respectively. The auditor may also consider it necessary to include an Other Matter paragraph in the auditor's report.⁶

A15. When the auditor concludes that withdrawal from the audit is necessary because of a scope limitation, there may be a professional, legal or regulatory requirement for the auditor to communicate matters relating to the withdrawal from the engagement to regulators or the entity's owners.

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

A16. The following are examples of reporting circumstances that would not contradict the auditor's adverse opinion or disclaimer of opinion:

- The expression of an unmodified opinion on financial statements prepared under a given financial reporting framework and, within the same report, the expression of an adverse opinion on the same financial statements under a different financial reporting framework.⁷
- The expression of a disclaimer of opinion regarding the results of operations, and cash flows, where relevant, and an unmodified opinion regarding the financial position (see ISA (NZ) 510⁸). In this case, the auditor has not expressed a disclaimer of opinion on the financial statements as a whole.

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

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

A17. Consistency in the auditor's report helps to promote users' understanding and to identify unusual circumstances when they occur. Accordingly, although uniformity in the wording of a modified opinion and in the description of the basis for the modification may not be possible, consistency in both the form and content of the auditor's report is desirable.

A18. An example of the financial effects of material misstatements that the auditor may describe in the basis for modification paragraph in the auditor's report is the quantification of the effects on income tax, income before taxes, net income and equity if inventory is overstated.

A19. Disclosing the omitted information in the basis for modification paragraph would not be practicable if:

- (a) The disclosures have not been prepared by management or the disclosures are otherwise not readily available to the auditor; or
- (b) In the auditor's judgement, the disclosures would be unduly voluminous in relation to the auditor's report.

⁶ ISA (NZ) 706, "Emphasis of Matter Paragraphs in the Independent Auditor's Report," paragraph A5.

⁷ See paragraph A32 of ISA (NZ) 700 for a description of this circumstance.

⁸ ISA (NZ) 510, "Initial Audit Engagements—Opening Balances," paragraph 10.

A20. An adverse opinion or a disclaimer of opinion relating to a specific matter described in the basis for qualification paragraph does not justify the omission of a description of other identified matters that would have otherwise required a modification of the auditor's opinion. In such cases, the disclosure of such other matters of which the auditor is aware may be relevant to users of the financial statements.

Opinion Paragraph (Ref: Para. 22-23)

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

A22. When the auditor expresses a qualified opinion, it would not be appropriate to use phrases such as "with the foregoing explanation" or "subject to" in the opinion paragraph as these are not sufficiently clear or forceful.

Illustrative Auditors' Reports

A23. Illustrations 1 and 2 in the Appendix contain auditors' reports with qualified and adverse opinions, respectively, as the financial statements are materially misstated.

A24. Illustration 3 in the Appendix contains an auditor's report with a qualified opinion as the auditor is unable to obtain sufficient appropriate audit evidence. Illustration 4 contains a disclaimer of opinion due to an inability to obtain sufficient appropriate audit evidence about a single element of the financial statements. Illustration 5 contains a disclaimer of opinion due to an inability to obtain sufficient appropriate audit evidence about multiple elements of the financial statements. Illustration 6 contains a disclaimer of opinion due to an inability to obtain sufficient appropriate audit evidence about any elements of the financial statements. In each of the latter three cases, the possible effects on the financial statements of the inability are both material and pervasive.

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

A25. Communicating with those charged with governance the circumstances that lead to an expected modification to the auditor's opinion and the proposed wording of the modification enables:

- (a) The auditor to give notice to those charged with governance of the intended modification(s) and the reasons (or circumstances) for the modification(s);
- (b) The auditor to seek the concurrence of those charged with governance regarding the facts of the matter(s) giving rise to the expected modification(s), or to confirm matters of disagreement with management as such; and
- (c) Those charged with governance to have an opportunity, where appropriate, to provide the auditor with further information and explanations in respect of the matter(s) giving rise to the expected modification(s).

Appendix

(Ref: Para. A23-24)

Illustrations of Auditors' Reports with Modifications to the Opinion

- Illustration 1: An auditor's report for a reporting entity as defined in the Financial Reporting Act 1993 containing a qualified opinion due to a material misstatement of the financial statements.
- Illustration 2: An auditor's report for a reporting entity as defined in the Financial Reporting Act 1993 containing an adverse opinion due to a material misstatement of the financial statements.
- Illustration 3: An auditor's report for a reporting entity as defined in the Financial Reporting Act 1993 containing a qualified opinion due to the auditor's inability to obtain sufficient appropriate audit evidence.
- Illustration 4: An auditor's report for a reporting entity as defined in the Financial Reporting Act 1993 containing a disclaimer of opinion due to the auditor's inability to obtain sufficient appropriate audit evidence about a single element of the financial statements.
- Illustration 5: An auditor's report for a reporting entity as defined in the Financial Reporting Act 1993 containing a disclaimer of opinion due to the auditor's inability to obtain sufficient appropriate audit evidence about multiple elements of the financial statements.
- Illustration 6: An auditor's report for a reporting entity as defined in the Financial Reporting Act 1993 containing a disclaimer of opinion due to the auditor's inability to obtain sufficient appropriate audit evidence about any element of the financial statements.

Illustration 1:

Circumstances include the following:

- **Audit of a complete set of general purpose financial statements of a reporting entity as defined by the Financial Reporting Act 1993.**
- **The terms of the audit engagement reflect the description of the responsibility of those charged with governance for the financial statements in ISA (NZ) 210.⁹**
- **Inventories are misstated. The misstatement is deemed to be material but not pervasive to the financial statements.**

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of ABC Limited

Report on the Financial Statements

We have audited the financial statements of ABC Limited on pages to, which comprise the balance sheet as at December 31, 20X1, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors' Responsibility for the Financial Statements

The directors are responsible for the preparation of financial statements in accordance with generally accepted accounting practice in New Zealand and that give a true and fair view of the matters to which they relate, and for such internal control as the directors determine is necessary to enable the preparation of 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 International Standards on Auditing (New Zealand). 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 entity's preparation of financial statements that give a true and fair view of the matters to which they relate in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.¹⁰ An audit also includes evaluating the

⁹ ISA (NZ) 210, "Agreeing the Terms of Audit Engagements."

¹⁰ 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

appropriateness of accounting policies used and the reasonableness of accounting estimates, 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 unmodified opinion on cash flows and our qualified audit opinion on financial position and financial performance.

Other than in our capacity as auditor we have no relationship with, or interests in, ABC Limited.

Basis for Qualified Opinion on Financial Position and Financial Performance

The company's inventories are carried in the balance sheet at xxx. The directors have not stated the inventories at the lower of cost and net realisable value but have stated them solely at cost, which constitutes a departure from the New Zealand Equivalents to International Financial Reporting Standards. The company's records indicate that had the directors stated the inventories at the lower of cost and net realisable value, an amount of xxx would have been required to write the inventories down to their net realisable value. Accordingly, cost of sales would have been increased by xxx, and income tax, net income and shareholders' equity would have been reduced by xxx, xxx and xxx, respectively.

Qualified Opinion on Financial Position and Financial Performance

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph the financial statements on pages to

- comply with generally accepted accounting practice in New Zealand;
- give a true and fair view of the financial position of ABC Limited as at December 31, 20X1, and of its financial performance for the year then ended.

Opinion on Cash Flows

In our opinion, the financial statements on pages togive a true and fair view of cash flows of ABC Limited for the year ended December 31, 20X1.

Report on Other Legal and Regulatory Requirements

In accordance with the Financial Reporting Act 1993, we report that:

- We have obtained all the information and explanations that we have required.
- In our opinion proper accounting records have been kept by ABC Limited as far as appears from an examination of those records.

[Add any matters required to be included under any other legislation or regulation.]

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

preparation of financial statements that give a true and fair view of the matters to which they relate in order to design audit procedures that are appropriate in the circumstances.”

Illustration 2:

Circumstances include the following:

- **Audit of consolidated general purpose financial statements prepared for a reporting entity as defined by the Financial Reporting Act 1993.**
- **The terms of the audit engagement reflect the description of the responsibility of those charged with governance for the financial statements in ISA (NZ) 210**
- **The financial statements are materially misstated due to the non-consolidation of a subsidiary. The material misstatement is deemed to be pervasive to the financial statements. The effects of the misstatement on the financial statements have not been determined because it was not practicable to do so.**

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of ABC Limited

Report on the Financial Statements

We have audited the financial statements of ABC Limited and group, on pages to, which comprise the consolidated and separate balance sheets of ABC Limited as at December 31, 20X1, the consolidated and separate income statements, statements of changes in equity and cash flow statements for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors' Responsibility for the Financial Statements

The directors are responsible for the preparation of financial statements in accordance with generally accepted accounting practice in New Zealand and that give a true and fair view of the matters to which they relate, and for such internal control as the directors determine is necessary to enable the preparation of 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 International Standards on Auditing (New Zealand). 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 entity's preparation of financial statements that give a true and fair view of the matters to which they relate in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.¹¹ An audit also includes evaluating the

¹¹ 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

appropriateness of accounting policies used and the reasonableness of accounting estimates, 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 unmodified opinion on the separate financial statements of ABC Limited and our adverse audit opinion on the consolidated financial statements.

Other than in our capacity as auditor we have no relationship with, or interests in, ABC Limited or any of its subsidiaries.

Basis for Adverse Opinion on the Group Financial Statements

As explained in Note X, the company has not consolidated the financial statements of subsidiary XYZ Company it acquired during 20X1 because it has not yet been able to ascertain the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This investment is therefore accounted for on a cost basis. Under the New Zealand Equivalents to International Financial Reporting Standards, 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 on the Group Financial Statements

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion paragraph, the group financial statements on pages to

- do not comply with generally accepted accounting practice in New Zealand;
- do not give a true and fair view of the financial position of ABC Limited group as at December 31, 20X1, and the financial performance and cash flows of the group for the year then ended.

Opinion on ABC Limited Separate Financial Statements

In our opinion, the financial statements on pages togive a true and fair view of the financial position of ABC Limited as at December 31, 20X1, and its financial performance and cash flows for the year ended on that date.

Report on Other Legal and Regulatory Requirements

In accordance with the Financial Reporting Act 1993, we report that:

- In the above respect alone we have not obtained all the information and explanations we have required.
- In our opinion proper accounting records have been kept by ABC Limited as far as appears from our examination of those records.

[Add any matters required to be included under any other legislation or regulation.]

follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of financial statements that give a true and fair view of the matters to which they relate in order to design audit procedures that are appropriate in the circumstances."

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

Illustration 3:

Circumstances include the following:

- **Audit of a complete set of general purpose financial statements for a reporting entity as defined by the Financial Reporting Act 1993.**
- **The terms of the audit engagement reflect the description of the responsibility of those charged with governance for the financial statements in ISA (NZ) 210.**
- **The auditor was unable to obtain sufficient appropriate audit evidence regarding an investment in a foreign affiliate. The possible effects of the inability to obtain sufficient appropriate audit evidence are deemed to be material but not pervasive to the financial statements.**

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of ABC Limited

Report on the Financial Statements

We have audited the financial statements of ABC Limited on pages to, which comprise the balance sheet as at December 31, 20X1, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors' Responsibility for the Financial Statements

The directors are responsible for the preparation of financial statements in accordance with generally accepted accounting practice in New Zealand and that give a true and fair view of the matters to which they relate, and for such internal control as the directors determine is necessary to enable the preparation of 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 International Standards on Auditing (New Zealand). 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 entity's preparation of financial statements that give a true and fair view of the matters to which they relate in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.¹² An audit also includes evaluating the

¹² 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

appropriateness of accounting policies used and the reasonableness of accounting estimates, 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 unmodified opinion on cash flows and our qualified audit opinion on financial position and financial performance.

Other than in our capacity as auditor we have no relationship with, or interests in, ABC Limited.

Basis for Qualified Opinion on Financial Position and Financial Performance

ABC Limited's investment in XYZ Limited, a foreign associate acquired during the year and accounted for by the equity method, is carried at xxx on the balance sheet as at December 31, 20X1, and ABC's share of XYZ's net income of xxx is included in ABC's income for the year then ended. We were unable to obtain sufficient appropriate audit evidence about the carrying amount of ABC's investment in XYZ as at December 31, 20X1 and ABC's share of XYZ's net income for the year because we were denied access to the financial information, management, and the auditors of XYZ. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.

Qualified Opinion on Financial Position and Financial Performance

In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements on pages to

- Comply with generally accepted accounting practice in New Zealand;
- Give a true and fair view of the financial position of ABC Limited as at December 31, 20X1, and of its financial performance for the year then ended.

Opinion on Cash Flows

In our opinion, the financial statements on pages togive a true and fair view of the cash flows of ABC Limited for the year ended December 31, 20X1.

Report on Other Legal and Regulatory Requirements

In accordance with the Financial Reporting Act 1993, we report that:

- In the above respect alone we have not obtained all the information and explanations that we have required.
- In our opinion proper accounting records have been kept by ABC Limited as far as appears from our examination of those records.

[Add any matters required to be included under any other legislation or regulation.]

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

preparation of financial statements that give a true and fair view of the matters to which they relate in order to design audit procedures that are appropriate in the circumstances.”

Illustration 4:

Circumstances include the following:

- **Audit of a complete set of general purpose financial statements for a reporting entity as defined by the Financial Reporting Act 1993.**
- **The terms of the audit engagement reflect the description of the responsibility of those charged with governance for the financial statements in ISA (NZ) 210.**
- **The auditor was unable to obtain sufficient appropriate audit evidence about a single element of the financial statements. That is, the auditor was also 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.**

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of ABC Limited

Report on the Financial Statements

We were engaged to audit the financial statements of ABC Limited on pages to, which comprise the balance sheet as at December 31, 20X1, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors' Responsibility for the Financial Statements

The directors are responsible for the preparation of these financial statements in accordance with generally accepted accounting practice in New Zealand and that give a true and fair view of the matters to which they relate, and for such internal control as the directors determine is necessary to enable the preparation of 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 conducting the audit in accordance with International Standards on Auditing (New Zealand). 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.

Other than in our capacity as auditor we have no relationship with, or interests in, ABC Limited.

Basis for Disclaimer of Opinion

An audit would ordinarily involve performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected would ordinarily 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 entity's preparation of financial statements that give a true and fair view of the matters to which they

relate in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.¹³

The company's investment in its joint venture XYZ (Country X) Limited is carried at xxx on the company's balance sheet, which represents over 90% of the company's net assets as at December 31, 20X1. We were not allowed access to the management and the auditors of XYZ, including XYZ's auditors' audit documentation. As a result, the scope of our audit was limited and we were unable to undertake adequate audit procedures in respect of that aspect of this audit. We were unable to determine whether any adjustments were necessary in respect of the company's proportional share of XYZ's assets that it controls jointly, its proportional share of XYZ's liabilities for which it is jointly responsible, its proportional share of XYZ's income and expenses for the year, and the elements making up the statement of changes in equity and 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 on pages to

Report on Other Legal and Regulatory Requirements

In accordance with the Financial Reporting Act 1993, we report that:

- As noted above we have not received all the information and explanations we have required.
- In our opinion proper accounting records have been kept by ABC Limited as far as appears from our examination of those records.

[Add any matters required to be included under any other legislation or regulation.]

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

¹³ In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of 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 of financial statements that give a true and fair view of the matters to which they relate in order to design audit procedures that are appropriate in the circumstances."

Illustration 5:

Circumstances include the following:

- **Audit of a complete set of general purpose financial statements for a reporting entity as defined by the Financial Reporting Act 1993.**
- **The terms of the audit engagement reflect the description of responsibility of those charged with governance for the financial statements in ISA (NZ) 210.**
- **The auditor was unable to obtain sufficient appropriate audit evidence about multiple elements of the financial statements. That is, the auditor was unable to obtain audit evidence about the entity's inventories and accounts receivable. The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements.**

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of ABC Limited

Report on the Financial Statements

We were engaged to audit the financial statements of ABC Limited on pages to, which comprise the balance sheet as at December 31, 20X1, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors' Responsibility for the Financial Statements

The directors are responsible for the preparation of financial statements in accordance with generally accepted accounting practice in New Zealand and that give a true and fair view of the matters to which they relate, and for such internal control as the directors determine is necessary to enable the preparation of 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 conducting the audit in accordance with International Standards on Auditing (New Zealand). 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.

Other than in our capacity as auditor we have no relationship with, or interests in, ABC Limited.

Basis for Disclaimer of Opinion

An audit would ordinarily involve performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected would ordinarily 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 entity's preparation of financial statements that give a true and fair view of the matters to which they

relate in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.¹⁴

We were not appointed as auditors of the company until after December 31, 20X1 and thus did not observe the counting of physical inventories at the beginning and end of the year. We were unable to satisfy ourselves by alternative means concerning the inventory quantities held at December 31, 20X0 and 20X1 which are stated in the balance sheet at xxx and xxx, respectively. In addition, the introduction of a new computerised accounts receivable system in September 20X1 resulted in numerous errors in accounts receivable. As of the date of our audit report, management was still in the process of rectifying the system deficiencies and correcting the errors. We were unable to confirm or verify by alternative means accounts receivable included in the balance sheet at a total amount of xxx as at December 31, 20X1. As a result of these matters, the scope of our audit was limited and 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 income statement, statement of changes in equity 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 on pages to

Report on Other Legal and Regulatory Requirements

In accordance with the Financial Reporting Act 1993, we report that:

- As noted above we have not received all the information and explanations that we have required.
- Because of the items noted above we are unable to determine whether proper accounting records have been kept by ABC Limited.

[Add any matters required to be included under any other legislation or regulation.]

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

¹⁴ In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of 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 of financial statements that give a true and fair view of the matters to which they relate in order to design audit procedures that are appropriate in the circumstances."

Illustration 6:

Circumstances include the following:

- **Audit of a complete set of general purpose financial statements for a reporting entity as defined by the Financial Reporting Act 1993.**
- **The terms of the audit engagement reflect the description of responsibility of those charged with governance for the financial statements in ISA (NZ) 210.**
- **The auditor was unable to obtain sufficient appropriate audit evidence as a consequence of a fire at head office which destroyed many of the accounting records. The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements.**

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of ABC Limited

Report on the Financial Statements

We were engaged to audit the financial statements of ABC Limited on pages to, which comprise the balance sheet as at December 31, 20X1, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors' Responsibility for the Financial Statements

The directors are responsible for the preparation of financial statements in accordance with generally accepted accounting practice in New Zealand and that give a true and fair view of the matters to which they relate, and for such internal control as the directors determine is necessary to enable the preparation of 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 conducting the audit in accordance with International Standards on Auditing (New Zealand). 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.

Other than in our capacity as auditor we have no relationship with, or interests in, ABC Limited.

Basis for Disclaimer of Opinion

An audit would ordinarily involve performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected would ordinarily 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 would ordinarily consider internal control relevant to the entity's preparation of financial statements that give a true and fair view of the matters to which they relate in order to design audit procedures that are appropriate in the

circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.¹⁵

We were unable to access many of the accounting records as a consequence of a fire at the company's head office which destroyed many of the accounting records. The financial report consequentially includes a number of material amounts based on estimates. However, we were unable to undertake any audit procedures on these estimates.

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 on pages to

Report on Other Legal and Regulatory Requirements

In accordance with the Financial Reporting Act 1993, we report that:

- As noted above we have not received all the information and explanations that we have required.
- Because of the items noted above we are unable to determine whether proper accounting records have been kept by ABC Limited.

[Add any matters required to be included under any other legislation or regulation.]

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

¹⁵ In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of 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 of financial statements that give a true and fair view of the matters to which they relate in order to design audit procedures that are appropriate in the circumstances."

ACCOMPANYING ATTACHMENT: SIMILARITY TO THE INTERNATIONAL STANDARDS ON AUDITING

This conformity statement accompanies but is not part of ISA (NZ) 705.

Conformity with International Standards on Auditing

This ISA (NZ) conforms to International Standard on Auditing (ISA) 705 *Modifications to the Opinion in the Independent Auditor's Report*, issued by the International Auditing and Assurance Standards Board (IAASB), an independent standard-setting board of the International Federation of Accountants (IFAC).

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

The following requirement is additional to ISA 705 and ASA 705:

- Where the audit engagement is subject to the requirements of the Financial Reporting Act 1993, the audit report is required to state the work done by the auditor and the scope and limitations of the audit. Therefore, in the situation described in paragraph 27, the auditor shall include in the Basis for Disclaimer of Opinion paragraph details outlining the work done and the scope and limitation of the audit. Illustrations 4 to 6 give examples of wording to meet this requirement. [Ref. Para. NZ 27.1]

This ISA (NZ) incorporates terminology and definitions used in New Zealand.

Compliance with this ISA (NZ) enables compliance with ISA 705.

Comparison with Australian Auditing Standards

In Australia the Australian Auditing and Assurance Standards Board (AUASB) has issued Australian Auditing Standard ASA 705 *Modifications to the Opinion in the Independent Auditor's Report*.

ASA 705 conforms to ISA 705.

The following requirements are additional to ISA 705 and ISA (NZ) 705:

- If there is a material misstatement of the financial report that relates to the non-disclosure of information required to be disclosed, the auditor shall:
 - ◆ Request management and/or those charged with governance to correct the non-disclosure in the financial report.. [Ref: Para. Aus 19.1]
 - ◆ Where, under paragraph 19(c) of this Auditing Standard, the omitted disclosures are not included in the basis of modification paragraph, the auditor shall include the reasons for the omission from the basis of modification paragraph. [Ref: Para. Aus 19.2]