Modified opinions

MODULE 4 | 4.3.4 | STUDENT COMPANION

An opinion is modified when the statements are **materially misstated**, or when the auditor **can't obtain sufficient appropriate evidence** that they aren't. Two questions decide which modified opinion: the **nature** of the problem, and whether its effects, or possible effects, are **pervasive**. A material but contained problem gives a **qualified** opinion of either kind; a pervasive misstatement gives an **adverse** opinion; pervasive possible effects of missing evidence give a **disclaimer**. The basis section explains the matter and, where practicable, its financial effect.

Which modified opinion?

	Material, but not pervasive	Material and pervasive
Material misstatement The statements are materially misstated	**QUALIFIED** 'Except for the effects of the matter...' **Voltana, had management refused** the $600,000 warranty increase: a misstatement confined to one provision and its expense	**ADVERSE** '...do not give a true and fair view' **A property developer (imagined)** books the full profit on off-the-plan apartment sales when buyers sign, years before settlement, and refuses to change
Can't obtain evidence No sufficient appropriate evidence	**QUALIFIED** 'Except for the possible effects of the matter...' **A timber yard (imagined):** auditor appointed after year end, too late for the stocktake; inventory material but contained	**DISCLAIMER** 'We do not express an opinion' **A company (imagined)** whose accounting system was destroyed in a cyber attack, with failed backups

Pervasive effects aren't confined to particular items; or, if they are, they make up a substantial proportion of the statements; or, for disclosures, they are fundamental to users' understanding.

Reading the examples: at Voltana, the refused $600,000 would on its own exceed materiality of about $480,000, and with the other uncorrected items would total about $790,000. It is material, but confined to one provision and its expense, so the opinion would be qualified. The developer's single profit policy misstates revenue, profit, receivables, inventory and the related disclosures right across the statements, so it is pervasive. At the timber yard only inventory, and the cost of sales it feeds, is in doubt; after the cyber attack, most balances can't be verified at all.

How the auditor's report changes

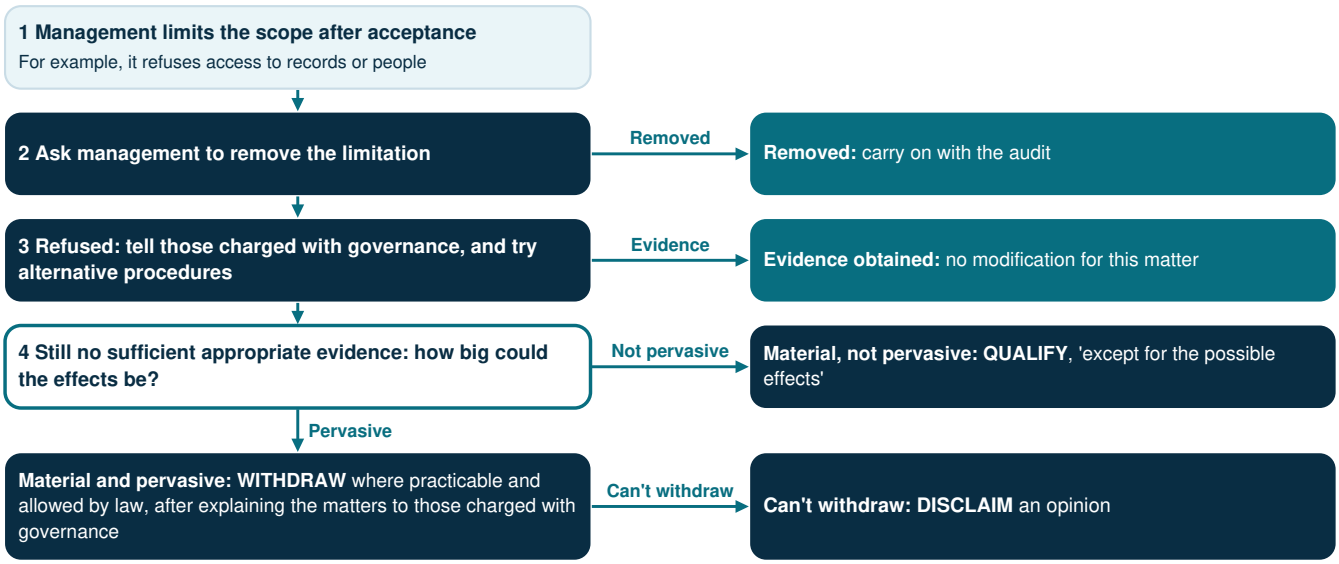
	Unmodified	Qualified or adverse	Disclaimer
Opinion heading	Opinion	Qualified Opinion, or Adverse Opinion	Disclaimer of Opinion
Key wording	'...gives a true and fair view...'	'Except for the (possible) effects of...', or '...does not give a true and fair view'	'We were engaged to audit...' and 'We do not express an opinion'
Basis section	Basis for Opinion	Basis for Qualified (or Adverse) Opinion: describes the matter; quantifies the financial effects where practicable, or says why not; describes omitted disclosures and includes them if practicable	Basis for Disclaimer of Opinion: explains why the evidence couldn't be obtained
'Evidence is sufficient and appropriate'	Yes	Yes, 'for our qualified (adverse) opinion'	Not stated
Auditor's responsibilities	Full description	Full description	Cut back: engaged to audit, but couldn't obtain the evidence
Key Audit Matters and Other Information sections	Included where they apply	Included; the modifying matter is referred to, not described as a key audit matter	Neither section, unless the law requires it

Whenever a modified opinion is expected: tell those charged with governance in advance, with the circumstances and the proposed wording.

Why a disclaimer isn't a harsher adverse opinion: they answer different questions. An adverse opinion is a firm conclusion, based on sufficient evidence, that the statements are pervasively wrong. A disclaimer says the auditor couldn't gather enough evidence to reach any conclusion: one says 'we know this is wrong', the other 'we can't tell'. That is also why a disclaimer drops the statements that would suggest assurance, including the Key Audit Matters and Other Information sections.

Multiple uncertainties: in extremely rare cases the auditor disclaims even with sufficient evidence about each of several uncertainties, because their possible interaction and combined effect make an opinion on the statements as a whole impossible.

When management limits the audit



Australia: a public company's auditor can resign only with ASIC's consent (s329(5)); not needed for a proprietary company or a small company limited by guarantee (s329(9))

Before acceptance: if a limitation would lead to a disclaimer, don't accept the engagement as an audit, unless the law requires it

Australian points: the company's officers must give the auditor access to the books and the information, explanations and assistance the audit needs (s312), and a management-imposed limitation may itself have to be reported to ASIC under s311 as an attempt to interfere with the audit. Before accepting an engagement, an auditor shouldn't accept it as an audit if a limitation in its proposed terms would lead to a disclaimer, unless the law requires it (ASA 210).

See also: the Exam Reference Pack, page 8, for the full opinion decision path.

Practice questions

MODULE 4 | 4.3.4 | TRY THESE BEFORE THE WORKED ANSWERS

Question 1 - Which opinion?

For each situation, say which opinion the auditor should give, and why.

Situation (all imagined companies)	Opinion	Why
(a) **Numbat Glassworks Ltd** closed one of its three furnaces in May. The board refuses to write down the idle furnace, carried at $3.2 million; its recoverable amount is $0.4 million. Profit before tax is $11 million; materiality is $550,000.		
(b) **Dollarbird Recruitment Ltd** recognises the full value of three-year staffing contracts as revenue when they are signed, not as the staff are provided. Revenue, receivables, contract liabilities, profit, equity and most notes are affected.		
(c) **Snowgum Lifts Ltd:** a server failure destroyed the ticket-scanning records for one resort's July school holidays, and no other evidence of that revenue exists. It is material; everything else is well supported.		
(d) **Firetail Laundries Ltd:** the directors refuse to sign written representations that they have met their responsibility for the financial report and given the auditor all relevant information.		
(e) **Gidgee Data Centres Ltd:** a $70 million loan falls due in six months and refinancing talks continue. Note 2 explains this clearly and states that a material uncertainty exists.		
(f) **Quokka Books Ltd:** management declines to correct a $35,000 overstatement of depreciation. Materiality is $900,000, and no qualitative factor makes it material.		

Question 2 - Draft the Basis for Qualified Opinion

Draft the Basis for Qualified Opinion paragraph for Numbat Glassworks in situation (a), including the financial effect of the matter. Ignore tax.

Question 3 - The withheld board minutes

You are auditing Kinchela Tiles Ltd (imagined), an unlisted public company that makes ceramic tiles. During the final audit, its managing director refuses to let you read the board minutes for the last two months of the year, saying they cover only 'confidential strategy'. Plan your response, step by step.

Worked answers

MODULE 4 | 4.3.4 | WORKED ANSWERS - ATTEMPT THE QUESTIONS FIRST

Question 1 - The opinions

Situation	Opinion	Why
(a) Numbat Glassworks	Qualified ('except for the effects')	A $2.8 million overstatement is material, but confined to one asset and its expense: not pervasive
(b) Dollarbird Recruitment	Adverse	The misstatement runs through revenue, receivables, liabilities, profit, equity and most notes: material and pervasive
(c) Snowgum Lifts	Qualified ('except for the possible effects')	An inability to obtain evidence, material but confined to one revenue stream: not pervasive
(d) Firetail Laundries	Disclaimer	Without the representations about the directors' own responsibilities, the auditor must disclaim (ASA 580); the evidence gap is pervasive
(e) Gidgee Data Centres	Unmodified, with a Material Uncertainty Related to Going Concern section	The uncertainty is adequately disclosed, so the statements aren't misstated
(f) Quokka Books	Unmodified	The misstatement is clearly below materiality with no qualitative factor; it is still communicated and covered in the representations

Question 2 - Numbat Glassworks: a sample paragraph

Basis for Qualified Opinion. Property, plant and equipment includes a furnace, idle since May 2026, carried at $3.2 million (see the property, plant and equipment note). Its recoverable amount is $0.4 million, and AASB 136 Impairment of Assets requires it to be written down to that amount. Had it been written down, property, plant and equipment and equity would each be $2.8 million lower, and an impairment expense of $2.8 million would reduce profit before tax from $11.0 million to $8.2 million. [The standard statements follow: the audit was conducted under the Australian Auditing Standards; independence; and the evidence is sufficient and appropriate for our qualified opinion.]

The opinion paragraph then reads 'except for the effects of the matter described in the Basis for Qualified Opinion section', followed by the usual true and fair wording.

Question 3 - Kinchela Tiles: the response

- **Ask why, and treat it as a warning sign.** Minutes record decisions on borrowings, litigation, major contracts, related party dealings and events after year end. Withholding two months of them could hide something material, so raise your scepticism and reassess the risk of fraud.
- **Ask management to remove the restriction.** It is a management-imposed limitation on the scope of the audit, and officers must give the auditor access to the company's books, which include its minutes (s312).

- **If refused, tell those charged with governance:** the board, through its chair or the audit committee, and ask them to give access.
- **Try alternative procedures:** enquiries of the directors, including the non-executive directors; a review of events and documents after year end, such as legal letters and new contracts; and written representations about the matters discussed. These are unlikely to substitute fully for the minutes.
- **Decide the opinion.** Possible effects material but not pervasive: qualify ('except for the possible effects'). Material and pervasive: withdraw where practicable and allowed by law, after explaining the matters to those charged with governance; as Kinchela is a public company, resigning needs ASIC's consent (s329(5)). If you can't withdraw, disclaim.
- **Consider integrity and fraud.** Does the refusal cast doubt on management's integrity, and so on its representations? An attempt to interfere with the audit must be notified to ASIC under s311, as soon as practicable and within 28 days.
- **Communicate and document:** tell those charged with governance in advance of any expected modification and its wording, and record each step and your reasoning.