

Chapter 20—Audit Reports

1—report title—auditing standards require the report to be titled and the title include the word “independent”

2—audit report address—usually addressed to the company, its stockholders, or the B of D

4—scope paragraph—a factual statement about what the auditor did in the audit. Part of the scope paragraph discusses the audit evidence accumulated and states that the auditor believes the evidence accumulated was appropriate for the situation to express the opinion presented.

The scope paragraph also tells the reader that an audit provides a high level of assurance but it is not a guarantee. The words “test basis” indicate that sampling is used.

6—name of the CPA firm

7—audit report date—the appropriate date for the report is the one on which the auditor has completed the most important auditing procedures in the field. This date indicates the last day of the auditor’s responsibility for the review of significant events that occurred after the date of the financial statements.

Conditions Requiring a Departure

Three conditions requiring a departure from an unqualified report:

1—the scope of the auditor’s exam has been restricted

--2 major causes of scope restrictions

1. restrictions imposed by the client

- 2. restrictions caused by circumstances beyond the control of the client or auditor**

Audit Reports Other Than Qualified

1—adverse opinion—used only when the auditor believes the overall financial statements are so materially misstated or misleading that they do not present fairly the financial position or results of operations or cash flows in conformity with GAAP

2—disclaimer of opinion—issued whenever the auditor has been unable to satisfy himself that the overall financial statements are fairly presented. It may arise because of a severe limitation on audit scope or a nonindependent relationship.

It is distinguished from an adverse opinion in that it can arise only from a lack of knowledge by the auditor.

Disclaimers and adverse opinions are used only when the condition is highly material.

3—qualified opinion

--Such an opinion can result from a scope limitation or failure to follow GAAP

--It can be used only when the auditor believes that the overall financial statements are not fairly stated

--This type of opinion can take the form of a qualification of both the scope and the opinion or of the opinion alone

Materiality

1—amounts are immaterial

--Results in an unqualified opinion

2—amounts are material but do not overshadow the financial statements as a whole

--This exists when a misstatement would affect a user's decision but the overall statements are fairly stated

--Here a qualified opinion is OK

3—amounts are so material or pervasive that overall fairness of statements is in question

--An auditor must issue a disclaimer of opinion or an adverse opinion

--The extent to which an exception affects different parts of the financial statements is pervasiveness

--As errors become more pervasive the likelihood of issuing an adverse opinion increases

--A disclaimer must be issued if independence is lacking

Materiality decisions—non-GAAP conditions

1—dollar amounts compared with a base

--When a client has failed to follow GAAP, we are concerned with the total dollar error in the accounts involved compared with some base

--To evaluate overall materiality the auditor must combine all unadjusted errors and judge whether there may be individually immaterial errors that when combined, significantly affect the statements

2—measurability

--The dollar error of some misstatements cannot be accurately measured

--Here the auditor must consider the effect on statement users of the failure to make a disclosure

3—nature of the item

--A user's decision may also be affected by the kind of error in the statement

Discussion of Conditions Requiring a Departure

When restrictions are due to conditions beyond the client's control, a qualification of scope and opinion is in order.

When amounts are so material, however, that a disclaimer of opinion rather than a qualified opinion is required, the auditor uses only three paragraphs.

Statements Are Not in Conformity with GAAP

Rule 203 reports

Rule 203—permits a departure from GAAP when the auditor believes that adherence to them would result in misleading statements. A complete explanation by the auditor should be provided in a third paragraph before the opinion paragraph.

Lack of statement of cash flows

When a statement of cash flows is omitted there must be a third paragraph stating the omission and an “except for” opinion qualification.

Unqualified Report with an Explanatory Paragraph

Lack of consistency

Consistency versus comparability—the auditor must be able to distinguish between changes that affect consistency and those that affect comparability but do not affect consistency. The following are changes that affect consistency and require an explanatory paragraph:

- 1. changes in accounting principle**
- 2. changes in reporting entities**
- 3. corrections of errors involving GAAP**

Substantial Doubt About Going Concern

1—significant recurring operating losses or working capital deficiencies

2—inability to pay debts as they come due

3—loss of major customers, occurrence of uninsured major catastrophes

4—legal or regulatory matters that could affect an entity's ability to continue as a going concern

The auditor's concern is the possibility that the client may not be able to continue for a reasonable period of time (not to exceed 1 year from the date of the financial statements)

Reports Involving Other Auditors

1—make no references in the audit report—this is typically followed when the other auditor examined an immaterial portion of the statements

2—make reference in the report

--This is called a shared opinion. It is used where it is impractical to review the work of the other auditor or the portion of the statements reviewed by the other auditor is material

3—qualify the opinion—a qualified opinion or disclaimer is required if the main auditor is not willing to assume any responsibility for the work of the other auditor

More Than One Condition Requiring a Departure

1. The auditor is not independent and the auditor knows the company has not followed GAAP