11

CHAPTER

AUDITOR'S REPORT[1]

The audit report : As a means of communication

11.1 The main objective of an independent financial audit is the expression of an opinion regarding the truthfulness and fairness of presentation of the financial statements. This opinion is communicated to the owners/members through the medium of audit report.

Certificate vs. Report

11.2 Audit report and Audit Certificate

Basis	*Audit report*	*Audit certificate*
Meaning	It is an expression of independent opinion on the financial statements of a company.	It is a written confirmation of the accuracy of the facts stated therein and does not involve estimate or opinion.
Nature	It is an opinion on reliability of the financial statements prepared by the entity.	It gives guarantee of absolute accuracy and correctness of the information contained therein *e.g.* statement contained in prospectus are to be certified by the auditor.
Responsibility of the auditor	The auditor is responsible to render his opinion with reasonable care and skill.	The auditor is responsible for absolute accuracy of facts stated therein.

1. Discussion in this chapter is largely based on the framework provided by SA 700, "*The Auditor's Report on Financial Statements*" issued by the ICAI.

Elements of Audit Report

11.3 According to **SA 700 (Revised) : Forming an Opinion on the Financial Statements** the auditor's report shall be in writing. It has mentioned the following elements of Audit Report

Title	The auditor's report shall have a title that clearly indicates that it is the report of an independent auditor.
Addressee	The auditor's report shall be addressed as required by the circumstances of the engagement.
Introductory paragraph	(*a*) Identify the entity whose financial statements have been audited; (*b*) State that the financial statements have been audited; (*c*) Identify the title of each statement that comprises the financial statements; (*d*) Refer to the summary of significant accounting policies and other explanatory information; and (*e*) Specify the date or period covered by each financial statement comprising the financial statements.
Management's responsibility for the financial statements	This section of the auditor's report (*a*) Describes the responsibilities of those in the organisation that are responsible for the preparation of the financial statements. (*b*) Includes an explanation that management is responsible for – ◆ the preparation of the financial statements in accordance with the applicable financial reporting framework; ◆ design, implementation and maintenance of internal control.
Auditor's responsibility	The auditor's report shall state that the responsibility of the auditor is to express an opinion on the financial statements based on the audit.
Auditor's opinion	When expressing an unmodified opinion on financial statements, the auditor's opinion shall state that the financial statements give a true and fair view.
Signature of the Auditor	The auditor's report shall be signed.
Date of the Auditor's Report	The auditor's report shall be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements.
Place	The report shall name a specific location, which is generally the city in which the auditor maintains his office.

Note : If the auditor addresses other reporting responsibilities in the auditor's report on the financial statements that are in addition to the auditor's responsibility under the SAs to report on the financial statements, these other reporting responsibilities shall be addressed in a separate section in the auditor's report that shall be sub-titled ***"Report on Other Legal and Regulatory Requirements"***.

Audit report of a limited company

11.4 These can be divided into three parts :

- Duty to report
- Duty to enquire
- Duty to report on additional matters

Duty to report

11.4-1 Section 143 (1) of the Companies Act, 2013 has laid down reporting requirements for the auditor. Under Section 143(2) of the Act the auditor has a duty to report to the members of the company on :

(*a*) accounts examined by him; and

(*b*) every financial statement[2] laid before a general meeting during his tenure.

Besides above , the matters on which an auditor has a duty to report under section 143(3) can broadly be divided in two categories :

- Statement of fact
- Opinions

(*i*) The statement of fact would relate to

(*a*) *Information and explanation* - whether he had obtained all the information and explanations, which were necessary for the purpose of his audit.

(*b*) *Branch auditor's report* - whether the report on the accounts of any branch office audited by a person other than the company's auditor has been forwarded to him and how he has dealt with the same in his report.

(*c*) *Financial statements and books of account* - whether the company's balance sheet and profit and loss account dealt with by the report are in agreement with books of account and returns.

(*d*) *Director's disqualification* - whether any director is disqualified from being appointed as director under section 164(2).

(*e*) *Qualification or adverse remark to be stated* - the auditor's report shall state any qualification, reservation or adverse *remark* relating to the maintenance of accounts and other matters connected therein.

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2. Section 2(40) of the Companies Act, 2013 defines the term "financial statement" in relation to a company to include:
   i. A balance sheet as at the end of the financial year;
   ii. A profit and loss account/Income and Expenditure account;
   iii. Cash flow statement for the year;
   iv. A statement of changes in equity, if applicable; and
   v. Any explanatory note annexed to, or forming part of any document referred to above.

(*f*) *Observation and comment on financial transaction* - any observation and comment of the auditor on financial transaction which have an adverse effect on the functioning of the company.

(*ii*) The auditor is required to express his opinion as to the following:

(*a*) *Proper books of account* - whether proper books of account as required by law have been kept by the company and proper returns adequate for the purposes of audit have been received from branches not visited by him.

(*b*) *Internal financial control system* - whether the company has an internal financial control system and it has operating effectiveness.

(*c*) *Accounting standards* - whether the financial statements comply with the accounting standards.

(*d*) *True and fair view* - whether the financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and in the case of the profit or loss and cash flow for the year and such other matters as may be prescribed.

Duty to enquire

11.4-2 Section 143(1) requires the auditor to enquire into following matters:

a. Secured loans and advances	◆ The auditor is required to ascertain the legality of the title of the security offered for loans and advances and should ensure that value of the security fully covers the amount of the loan or advance. ◆ The question as to *terms* [*i.e.* security offered, the interest charged and terms of repayment] on which such loans and advances have been made, is prejudicial to the interests of the company or not, is a matter of professional judgment of the auditor. *Example* - XYZ Co. appoints Mr. A as its CEO. He is very well-known in the industry for his leadership qualities and management skills. Mr. A joins the company on the condition that besides salary and other perks, the company would give him an interest-free fully secured housing loan of Rs. 10 lakhs repayable over a period of 10 years. The comparable market rate of interest for such a loan is 8%. If Mr. A is capable of giving a new thrust to the operations of the company and the profitability of the company is likely to increase under his leadership, the auditor may not consider this loan as prejudicial
b. Transactions represented merely by book entries	◆ The auditor should enquire whether transactions that are represented by book entries, in fact, have taken place, and are not prejudicial to the interests of the company.

	Example 1 - The books recorded payment for purchases made in cash. In reality no such transaction has taken place. The auditor's report should mention this fact. *Example 2* - Books of account of Flintos Ltd. showed that it obtained deposits from a 'friendly' source just before the year-end. The effect of the transaction is to increase the apparent size of deposits in the balance sheet. In the following financial year, these deposits are re-deposited with the same source. Thus, these transactions were only book entries and prejudicial to the interests of the company.
c. Sale of investment at less than purchase price	◆ The auditor is required to enquire in all cases where shares, debentures and other securities have been sold at a price less than their cost. The investment companies and banking companies are outside the ambit of this clause. *Example* : The books of a trading firm, PQR Ltd., for the year 2013-14 showed sale of 10,000 shares of XYZ Co. held by it at a loss of Rs. 80,000. Management actually intended to establish losses to reduce tax liability through this sale. The auditor must enquire and mention this fact in his report.
d. Loans and advances made by the company	◆ Loans and advances made to individuals or private concerns by the company and deposits with banks, public authorities, etc. are both shown as assets in the balance sheet of a company. The term *deposit* may be defined as the placing of money or money's worth with a third party, either for safe-keeping or by way of security or for the purpose of earning interest from the party who customarily accepts deposits[5]. Thus, the degree of risk associated with its repayment/encashment is far less than loans and advances. The auditor is required to enquire into the fact whether loans and advances have been shown as deposits and not *vice versa*.
e. Personal expenses	◆ At times managers or employees of the company charge to the company expenses incurred by them which, in fact, should have been borne by them. Some of the common examples of such situations are: charging expenses incurred in throwing a party to friends and relatives to the company as entertainment expenses and giving 'personal trips' the guise of 'official trips'. The auditor should report on such expenses.
f. Issue of shares for cash	◆ Examine as to whether cash has actually been received against the shares allotted for cash. For shares allotted for consideration other than cash, the auditor should ensure their adequate and cor-

	rect disclosure in account books and balance sheet. As per the decision in *Spargo's* case, shares allotted against a debt payable by the company may also be included under the expression 'shares allotted for cash'.

Duty to report on additional matters

11.4-3 Section 143(11) has empowered the Central Government to issue suitable instructions to auditors. According to this section, the Central Government may, in consultation with the National Financial Reporting Authority, direct auditors of companies specified in the order to report on additional matters.

Illustration of a complete auditor's report of a limited company is given in Figure 11.1.

FIGURE 11.1

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 in the Companies Act, 2013 ("the Forming an Opinion and Reporting on Financial Statement 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 and give a true and fair view in conformity with the accounting and auditing standards :

(*a*) in the case of the Balance Sheet, of the state of affairs of the Company as at March 31, 20XX;

(*b*) in the case of the Profit and Loss Account, of the profit/loss for the year ended on that date; and

(*c*) in the case of the Cash Flow Statement, of the cash flows for the year ended on that date.

Report on Other Legal and Regulatory Requirements

1. As required by the Companies (Auditor's Report) Order, 2016 issued by the Central Government of India, we give in the Annexure a statement on the matters specified in paragraphs 3 and 4 of the Order.
2. As required by section 143(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];
   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];
   d. in our opinion, the financial statements comply with the accounting standards.
   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 sub-section (2) of section 164 of the Companies Act, 2013

f. the company has an internal financial control system and it is operating effectively.

For XYZ & Co.
Chartered Accountants

Firm's Registration Number

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

True and fair view

Objective of financial audit

11.5-1 The main objective of financial audit is to enable the auditor to express an opinion as to whether balance sheet gives a 'true and fair view' of the state of affairs of a business as at the end of a financial year and whether profit and loss account shows a true and fair view of the profit or loss of the company for the given financial year. Section 143 of the Act also requires the auditor to express his opinion about the truthfulness and fairness of financial statements in the auditor's report.

Meaning of a 'true and fair view'

11.5-2 The phrase 'true and fair view' has not been defined in the Act. The definition given by ***Kent et al***[3], however, gives some guidance as to the basis on which the 'true and fair view' can be ascertained. According to them,

"Financial statements of an enterprise give a true and fair view if they, together with related notes, are sufficiently informative of matters that affect their use, understanding and interpretation by those for whom they are intended, and they are prepared in accordance with accounting principles appropriate to the circumstances of the business".

Extending the disclosure requirements mentioned in the definition, the auditor of a limited company may broadly consider the following aspects while expressing his opinion as to the truthfulness and fairness of financial statements:

(*i*) Financial statements - balance sheet and profit and loss account should be drawn up in conformity with the provisions of Schedule III of the Companies Act or those of the specific Acts governing certain classes of companies.

(*ii*) The information disclosed in the financial statements, in the case of limited companies, is clear, unambiguous and is as per the relevant

3. Kent David, Michael Sherer and Stuart Turley, *Current Issues in Auditing*, 1st edition, Harper & Row, London, pg. 144.

statutory requirements like requirements of disclosure as per the listing agreements for companies and requirements of the Companies Act, 2013. However, the auditor must remember that the Act has laid down only minimum reporting standards. If there is information, which though not mentioned in Schedule III of the Act, is material enough to influence the decision of shareholders/investors, the auditor should ensure its adequate disclosure in the financial statements.

(*iii*) The information is disclosed in the financial statements in a manner so as to enable users to draw conclusions consistent with the circumstances of business of the entity.

(*iv*) There is no over-statement or under-statement of financial position in the balance sheet and of working results in the profit and loss account.

(*v*) The financial statements are prepared in accordance with the generally accepted accounting principles which have been followed consistently.

(*vi*) Events occurring after the balance sheet date but material enough to influence the financial position as at the end of financial year should also be considered by the auditor.

(*vii*) All unusual, exceptional or non-recurring items have been disclosed separately.

The abovementioned aspects are only indicative in nature. What actually constitutes a 'true and fair view' in a particular circumstance is a matter of informed professional judgment of the auditor.

Types of audit report

11.6 Based on the kind of opinion expressed by the auditor, the audit report can be classified into five types—

- Unmodified opinion report
- Audit report with an 'emphasis of matter' paragraph
- Qualified report
- Disclaimer of opinion report
- Adverse report

The last three types of audit report are termed together as **modified reports** as per Standard on Auditing (SA) 705 : *Modifications to the Opinion in the Independent Auditor's Report*

Unmodified opinion report

11.6-1 Most common type of audit report is the unmodified opinion report. It is issued when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. Requirements of the applicable financial reporting framework which are to be met are:

(*i*) The financial statements adequately disclose the significant accounting policies selected and applied;

(ii) The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;

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

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

(v) The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements; and

(vi) The terminology used in the financial statements, including the title of each financial statement, is appropriate.

In case of a limited company, thus, if the auditor makes various statutory affirmations contained in section 143 without any reservation, he is said to have issued on unqualified audit report or clean report. An illustrative example of such a report is given in Figure 11.1.

Audit report with an 'emphasis of matter' or 'other matter' paragraph

11.6-2 According to Standard on Auditing (SA) 706 : *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report,* the auditor may put these paragraphs in the auditor's report when he considers it necessary to draw users' attention to a matter(s) which may or may not have been presented or disclosed in the financial statements but are fundamental to users' understanding of the financial statements. These paragraphs does not change the nature of the audit report as it relates to a matter that does not affect the auditor's opinion.

(i) A 'emphasis of matter' paragraph included in the auditor's report refers to a matter which has been appropriately presented or disclosed in the financial statements and is fundamental to users' understanding of the financial statements. Examples:

- Going concern doubt
- Significant uncertainty

(ii) An 'other matter ' paragraph included in the auditor's report refers to a matter other than those presented or disclosed in the financial statements and is relevant to users' the auditor's report. Examples:

- Reporting on more than one set of financial statements
- Restriction on distribution or use of the auditor's report

Example 1 : If there is **uncertainty** relating to a pending exceptional litigation matter. This is highlighted in the auditor's report by **an Emphasis of Matter paragraph.**

After opinion paragraph following shall be added

Emphasis of Matter

"We draw attention to Note X to the financial statements which describe the uncertainty related to the outcome of the law suit filed against the Company by XYZ Company. Our opinion is not qualified in respect of this matter."

Example 2 : In case of auditor of **Consolidated Financial Statements** 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.

After opinion paragraph following shall be added

Other Matter

"We did not audit the financial statements of certain subsidiaries, whose financial statements reflect total assets (net) of Rs. .... as at March 31, 20XX, total revenues of Rs. .... and net cash outflows amounting to Rs. .... 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."

Modified Report

11.6-3 According to Standard on Auditing (SA) 705 : *Modifications to the Opinion in the Independent Auditor's Report* modified report is issued when auditor expresses a qualified opinion or an adverse opinion or a disclaimer of opinion. Further the following points are to be noted:

(i) Different circumstances under which modified report is issued

Circumstances when a auditor shall express a qualified opinion	(*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.**
Circumstances when a auditor shall express an adverse opinion	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.**
Circumstances when a auditor shall express an disclaimer of opinion	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.

(ii) How to introduce modification paragraph

- **Basis for modification paragraph :** When the auditor modifies the opinion on the financial statements, the auditor shall, in addition to the specific elements required by the SA 700 (Revised), include a paragraph in the auditor's report that provides a description of 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.
- **Title of opinion paragraph :** 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.

- **Highlighting** : Modifications which deal with matters, which have an adverse effect on the functioning of the company should be in **thick type** or in *italics.*

Example 1. 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.

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. 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.

Qualified Opinion

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

(a) *in the case of the Balance Sheet, of the state of affairs of the Company as at March 31, 20XX;*

(b) *in the case of the Profit and Loss Account, of the profit/loss for the year ended on that date; and*

(c) *in the case of the Cash Flow Statement, of the cash flows for the year ended on that date.*

Example 2. 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.

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.

Example 3. 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.

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 Profit and Loss Account, of the profit/ loss for the year ended on that date; and*

(c) *in the case of the consolidated Cash Flow Statement, of the cash flows for the year ended on that date.*

Difference between qualified opinion, disclaimer of opinion and adverse opinion

11.6-4 The *underlying difference* between a qualified opinion, disclaimer of opinion and adverse opinion is the *auditor's professional judgment* about the *materiality* of the subject-matter of qualification and *its pervasiveness* *i.e.* the extent to which the misstatements affects different parts of financial statements *e.g.* if a misstatement in inventory is there, the auditor should consider the effect of such misstatement on total current assets, current liabilities, working capital, total assets, income-tax payable, excise duty payable, cost of goods sold and earnings available to shareholders.

The auditor issues a *qualified opinion* where he has certain reservations about the propositions under examination and they are material but not pervasive as to warrant an adverse opinion. The overall statements, despite misstatements, give a true and fair view. If in the above example, inventory is not a significant portion of assets, the auditor may give a qualified opinion otherwise an adverse report. To take another example, substantial amount of credit sales have been classified as cash sales, this may result in issuance of a qualified report because of materiality of the transaction. But, if credit sales of the same amount are not recorded in the books of account, adverse opinion may be issued because of its pervasiveness *i.e.* its effect on sales, account receivables, taxes payable, current assets, total assets, operating income and owner's equity. Thus, *as misstatements become more pervasive, the likelihood of issuing an adverse opinion than a qualified opinion increases.*

Similarly, in cases of *client imposed material limitations* on scope of audit, the auditor may issue a *disclaimer of opinion* instead of a qualified opinion.

Further, the fundamental difference between *a disclaimer of opinion and adverse opinion* is that in case of former there is *insufficient evidence* to form an opinion but *sufficient evidence* is available in case of the latter. In case of disclaimer of opinion, the auditor *is not sure* whether the financial statements give a true and fair view. But in case auditor gives an adverse opinion, he *categorically states* that financial statements do not give a true and fair view.

11.6-5 Difference between clean audit report and qualified audit report -

Basis	*Clean audit report*	*Qualified audit report*
(*i*) Meaning	Auditor expresses an unqualified audit opinion *i.e.* opinion without reservation therein	Auditor expresses an opinion with reservation therein
(*ii*) When issued	It is issued when— • financial statements give a true and fair view; • are prepared in accordance with GAAP; • comply with statutory requirements; and • disclosure is adequate.	It is issued when— • subject matter for reservation is material and but not pervasive; and • auditor believes that the overall financial statements give a true and fair view.
(*iii*) In case of limited company	If the auditor makes various statutory affirmations contained in section 227 without any reservation, he is said to have issued an unqualified/ clean report	If any of the statutory affirmations in section 227(2) and section 227(3) are answered in negative or with qualification by the auditor, the audit report would be termed as a 'qualified audit report'

Basis	*Clean audit report*	*Qualified audit report*
(*iv*) Inclusion of 'emphasis of matter' paragraph	• In certain cases auditor may attach a paragraph to an unqualified opinion to put 'emphasis on a matter', regarding financial statements due to its importance • Such a matter is, generally, included in a note to the financial statements which discusses it in greater detail	No such paragraph can be attached to a qualified report.