



COLLEGE OF
ACCOUNTING

**AUDITING/CORPORATE GOVERNANCE |
BASIC/INTERMEDIATE**

Video Transcription: Modified Audit Opinions



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Hello there, my name is Sumaya and this video will be answering the question, “What are modified audit opinions?”

Remember that at the end of the audit process, the auditor has to form an opinion on the financial statements. This opinion is based on the evaluation of all the audit evidence obtained during the audit. The audit opinion can either be unmodified or clean or it can be a modified audit opinion and it is expressed in a written report known as the audit report.

So, what does a modified audit opinion mean? A modified audit opinion is given to highlight that the auditors have a material concern with regards to the financial statements. When would an auditor offer a modified audit opinion? If either, or both, of these following reasons occur. If the auditor concludes, based on the audit evidence obtained, that the financial statements are materially misstated or if the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements are free from material misstatements

There are three types of modified audit opinions:

1. A qualified opinion (an “except for”)
2. An adverse opinion, and a
3. Disclaimer of opinion

So, how does the auditor decide on the type of modified audit opinion? The auditor will need to evaluate whether the misstatements identified during the audit are material and pervasive. This evaluation will then determine the type of modified audit opinion given. Let me explain the difference between misstatements that are material but not pervasive and misstatements that are material and pervasive

Let’s look at an example. Let’s assume a developer has indicated that they have student accommodation that could be used by your university. You are a member of the SRC. You have been tasked with assessing whether the student accommodation is suitable.

- **Scenario 1:** The rooms are all comfortable and well fitted out, but unit 16 on the end is next to a septic tank, which appears to be leaking and results in a bad smell in that unit. This doesn’t affect the other units. You feel that this is significant (material) and needs to be reported, but it doesn’t affect your overall opinion that the development is suitable for student accommodation. In other words, your opinion is that the bad smell is material to only one unit, and is not pervasive to all other units. Your report, with reasons, would be: “In my opinion, the student accommodation division of the university should lease the rooms in the development, except that unit 16 is not suitable and should be rejected.” (An “except for” opinion.)
- **Scenario 2:** The rooms are all comfortable and well fitted out but the whole complex is built on the border of the local sewage works and there is a foul smell, which spreads throughout all the units. The smell is pervasive and you don’t believe that any student should be expected to live under those conditions. Your report, with reasons, should be: “In my opinion, the development does not represent suitable accommodation for students.” (This is an adverse opinion.)



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- **Scenario 3:** You visit the development site, and note that all the rooms you visit are comfortable and well fitted out. The developer will however not give you access to unit 16. In other words, you were unable to inspect unit 16, which is material, and you are therefore unable to form an opinion on unit 16. Your report, with reasons, would be: “In my opinion, the student accommodation division of the university should lease the rooms in the development, except that unit 16 may be unsuitable and should not be accepted without further inspection.” (This is a limitation of scope, an “except for” opinion)
- **Scenario 4:** You visit the development, but the developer will not allow you to visit any of the units. You therefore cannot perform your inspection. In other words, you were unable to inspect any of the units. This is material and pervasive to your report. Your report, with reasons, would be: “I am unable to express an opinion as to whether or not the rooms are suitable as student accommodation.” (This is a limitation of scope, a disclaimer of opinion)

Remember, the type of modified audit opinion depends on the auditor’s evaluation of whether the misstatements are material and pervasive, or material and not pervasive. So, an item is material if it influences the decisions made by the users of the financial statements. Pervasive means that the misstatements are not confined to only a single or a few specific line items in the financial statements, that is, the material misstatements affect the financial statements as a whole or if the misstatement is found only in one single line item, the line item may represent a substantial proportion of the financial statements.

This video should have given you a better understanding of modified audit opinions.

Thank you for watching. Good day.