Unqualified audit report

Unqualified Audit Report An opinion is said to be unqualified when the Auditor concludes that the Financial Statements give a true and fair view in accordance with the financial reporting framework used for the preparation and presentation of the Financial Statements. An Auditor gives a clean opinion or Unqualified Opinion when he or she does not have any significant reservation in respect of matters contained in the Financial Statements. The most frequent type of report is referred to as the " Unqualified Opinion", and is regarded by many as the equivalent of a " clean bill of health" to a patient, which has led many to call it the " Clean Opinion", but in reality it is not a clean bill of health, because the Auditor can only provide reasonable assurance regarding the Financial Statements, not the health of the company itself, or the integrity of company records not part of the foundation of the Financial Statements, This type of report is issued by an auditor when the financial statements presented are free of material misstatements and are represented fairly in accordance with the Generally Accepted Accounting Principles (GAAP), which in other words means that the company's financial condition, position, and operations are fairly presented in the financial statements. It is the best type of report an auditee may receive from an external auditor. An Unqualified Opinion indicates the following — (1) The Financial Statements have been prepared using the Generally Accepted Accounting Principles which have been consistently applied; (2) The Financial Statements comply with relevant statutory requirements and regulations; (3) There is adequate disclosure of all material matters relevant to the proper presentation of the financial information subject to statutory requirements, where applicable; (4) Any changes in the accounting principles or in the method of their application and the effects thereof have been properly determined and disclosed in the Financial Statements. Qualified Opinion report A Qualified Opinion report is issued when the auditor encountered one of two types of situations which do not comply with generally accepted accounting principles, however the rest of the financial statements are fairly presented. This type of opinion is very similar to an unqualified or " clean opinion", but the report states that the financial statements are fairly presented with a certain exception which is otherwise misstated. The two types of situations which would cause an auditor to issue this opinion over the Unqualified opinion are: (1) Single deviation from GAAP — this type of qualification occurs when one or more areas of the financial statements do not conform with GAAP (e. g. are misstated), but do not affect the rest of the financial statements from being fairly presented when taken as a whole. Examples of this include a company dedicated to a retail business that did not correctly calculate the depreciation expense of its building. Even if this expense is considered material, since the rest of the financial statements do conform with GAAP, then the auditor qualifies the opinion by describing the depreciation misstatement in the report and continues to issue a clean opinion on the rest of the financial statements. (2) Limitation of scope — this type of qualification occurs when the auditor could not audit one or more areas of the financial statements, and although they could not be verified, the rest of the financial statements were audited and they conform GAAP. Examples of this include an auditor not being able to observe and test a company's inventory of goods. If the auditor audited the rest of the financial statements and is reasonably sure that they conform with GAAP, then the auditor simply states that the financial statements are fairly presented, with the exception of the inventory which could not be audited. Going concern Going concern is a term which means that an entity will continue to operate in the near future which is generally more than next 12 months, so long as it generates or obtains enough resources to operate. If the auditee is not a going concern, it means that it is either dissolved, bankrupt, shutdown, etc. Auditors are required to consider the going concern of an auditee before issuing a report.[7] If the auditee is a going concern, the auditor does not modify his/her report in any way. However, if the auditor considers that the auditee is not a going concern, or will not be a going concern in the near future, then the auditor is required to include an explanatory paragraph before the opinion paragraph or following the opinion papragraph, in the audit report explaining the situation,[7][8] which is commonly referred to as the going concern disclosure. Such an opinion is called an " unqualified modified opinion". Unfortunately, many auditors are increasingly reluctant to include this disclosure in their opinions, since it is considered a " self-fulfilling prophesy" by some.[7] This is because a disclosure for a lack of going concern is viewed negatively by investors, lending institutions, and credit agencies, and therefore reduces the chance that the auditee may obtain the capital or borrowing it needs to survive once the disclosure is made. If this situation occurs, the auditee is more likely to stop being a going concern while the auditor loses potential future audit engagements, and so the auditor may be pressured to avoid including a going concern disclosure. In a study performed on 2001 bankruptcies, nearly half (48%) of selected public companies who faced bankruptcy in 2001 did not have a " going concern disclosure" in the previous auditor's reports.[7] Additionally, 12 of the 20 largest bankruptcies in U. S. history occurred between 2001 and 2002 and none of them had a " going concern disclosure" in their previous auditor's report. Auditor Independence Auditor independence refers to the independence of the internal auditor or of the external auditor from parties that may have a financial interest in the business being audited. Independence requires integrity and an objective approach to the audit process. The concept requires the auditor to carry out his or her work freely and in an objective manner. The purpose of an audit is to enhance the credibility of financial statements by providing written reasonable assurance from an independent source that they present a true and fair view in accordance with an accounting standard. This objective will not be met if users of the audit report believe that the auditor may have been influenced by other parties, more specifically company managers/directors or by conflicting interests (e. g. if the auditor owns shares in the company to be audited). In addition to technical competence, auditor independence is the most important factor in establishing the credibility of the audit opinion. There are three main ways in which the auditor’s independence can manifest itself: Programming independence: essentially protects the auditor’s ability to select the most appropriate strategy when conducting an audit. Auditors must be free to approach a piece of work in whatever manner they consider best. As a client company grows and conducts new activities, the auditor’s approach will likely have to adapt to account for these. In addition, the auditing profession is a dynamic one, with new techniques constantly being developed and upgraded which the auditor may decide to use. The strategy/proposed methods which the auditors intends to implement cannot be inhibited in any way. While programming independence protects auditors’ ability to select appropriate strategies. Investigative independence: protects the auditor's ability to implement the strategies in whatever manner they consider necessary. Basically, auditors must have unlimited access to all company information. Any queries regarding a company's business and accounting treatment must be answered by the company. The collection of audit evidence is an essential process, and cannot be restricted in any way by the client company. Reporting independence: protects the auditors' ability to choose to reveal to the public any information they believe should be disclosed. If company directors have been misleading shareholders by falsifying accounting information, they will strive to prevent the auditors from reporting this. It is in situations like this when auditor independence is most likely to be compromised. Relationship with Clients This reliance on clients' fees may affect the independence of an auditor. If the auditor feels this client income is more important than their responsibilities to shareholders he may not perform the audit with the shareholder's interests in mind. The larger the fee income the more likely the auditor is to shirk his responsibilities and perform the audit without independence. This could lead to the manipulation of figures and exploitation of accounting standards. By performing the audit without independence the shareholders' may get misled, as the auditor is now reliant on the directors. To encourage auditors to maintain their independence they must be protected from the director's board. If they were able to challenge statements and figures without the risk of losing their job they would be more likely to work with complete independence. Ultimately, as long as the client determines audit appointments and fees an auditor will never be able to have complete economic independence. Possible future developments Service limitations Many have advocated that in order for an auditor to remain strictly independent they should not be allowed to provide audit clients with any other advisory services. This idea was detailed in the EC’s Eighth Directive and was designed to remove conflicts of interest arising from audit companies having a high percentage of total revenue staked in the contract of one client. To date this has not been made a requirement. Both auditors and their clients have argued that the knowledge acquired during the audit process can allow other services to be provided less expensively. Peer assessment A review of audit control procedures by another firm is a requirement in the US that must be satisfied once every three years. This has been implemented to ensure external audits are carried out with the utmost professionalism and independence at all times. Such a system has not been accepted by UK auditors; however, it is expected that many large firms already have peer reviews in place which are conducted by audit teams from offices in other parts of the country. Audit committees The recommendation for companies to form an audit committee was first made in the Cadbury Report (1992). A group of three to five non-executive directors from within the company are chosen to provide what is supposed to be a truly objective view on all aspects of the audit: from evaluation of internal control systems to recommendations on audit fee. Since the Cadbury Report, this practice has been implemented yet many still remain unconvinced of the neutrality of non-executive directors. Rotating external auditors It is widely believed that a mandatory rotation of audit firm could improve auditor independence. Firstly, current auditors will have no incentive to work in cahoots with their client if the contract is due to expire in the foreseeable future. Similarly, auditors will be less likely to forge relationships with directors and staff, thus will be less concerned about upsetting them through an unfavourable audit report. And because current auditors will know they are soon to be replaced, they will be inclined to produce audit reports which demonstrate high standards and are an exemplar of true independence, and avoid having any shortcomings exposed by the new audit team.