

## **Examples of Modified Auditors' Reports on Financial Statements Prepared in Accordance with the SME-FRS based on HKSA 701 "Modifications to the Independent Auditor's Report"**

### **Matters that do affect the auditor's opinion**

Example 1 – Qualified opinion – disagreement with management

Example 2 – Qualified opinion – limitation on the auditor's work

Example 3 – Disclaimer of opinion – limitation on the auditor's work

Example 4 – Adverse opinion – disagreement with management

## Example 1 – Qualified opinion – disagreement with management

### INDEPENDENT AUDITOR’S REPORT TO THE SHAREHOLDERS OF SME LIMITED

(incorporated in [country or place] with limited liability)<sup>1</sup>

#### Report on the Financial Statements

We have audited the financial statements of SME Limited (the “Company”) set out on pages ..... to ....., which comprise the balance sheet as at 31 December 200X, and the income statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

#### *Directors’ responsibility for the financial statements*

The directors are responsible for the preparation and presentation of these financial statements in accordance with Small and Medium-sized Entity Financial Reporting Standard (SME-FRS) issued by the Hong Kong Institute of Certified Public Accountants. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

[In addition, section 141D of the Hong Kong Companies Ordinance requires that the balance sheet together with the notes thereon should be prepared in accordance with the requirements of the Eleventh Schedule to that Ordinance.]<sup>2</sup>

#### *Auditor’s responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit<sup>3</sup>. We conducted our audit in accordance with Hong Kong Standards on Auditing and with reference to PN 900 (Revised) “Audit of Financial Statements Prepared in Accordance with the Small and Medium-sized Entity Financial Reporting Standard” issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to 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 entity’s preparation and presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, 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.

---

<sup>1</sup> In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

<sup>2</sup> This additional wording is required for companies incorporated in Hong Kong applying section 141D of the Hong Kong Companies Ordinance

<sup>3</sup> Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 “Auditors’ Duty of Care To Third Parties and The Audit Report”.

*Basis for qualified opinion*

Included in debtors shown on the balance sheet is an amount of HK\$X due from a debtor which has ceased trading. The Company has no security for this debt. On the basis that no security has been obtained and no cash has been received on the debt, in our opinion the Company should make a full provision for impairment of HK\$X, reducing profit before taxation for the year and net assets at 31 December 200X by that amount.

*Qualified opinion arising from disagreement about accounting treatment*

In our opinion, except for the effect on the financial statements of the matter described in the basis for qualified opinion paragraph, the financial statements have been properly prepared, in all material respects, in accordance with the SME-FRS. [In addition, in our opinion, except for the effect on the financial statements of the matter described in the basis for qualified opinion paragraph, the balance sheet together with the notes thereon is properly drawn up so as to exhibit a true and correct view of the state of the Company's affairs as at 31 December 200X according to the best of our information and explanations given to us, and as shown by the books of the Company.]<sup>2</sup>

**Report on other matters under section 141D of the Hong Kong Companies Ordinance**

[We report that we have obtained all the information and explanations which we have required.]<sup>2</sup>

XYZ & Co.

Certified Public Accountants (Practising) [or Certified Public Accountants]

[Address]

Date

## Example 2 – Qualified opinion - limitation on the auditor's work

### INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF SME LIMITED

(incorporated in [country or place] with limited liability)<sup>1</sup>

#### Report on the Financial Statements

We have audited the financial statements of SME Limited (the "Company") set out on pages ..... to....., which comprise the balance sheet as at 31 December 200X, and the income statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

#### *Directors' responsibility for the financial statements*

The directors are responsible for the preparation and presentation of these financial statements in accordance with Small and Medium-sized Entity Financial Reporting Standard (SME-FRS) issued by the Hong Kong Institute of Certified Public Accountants. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

[In addition, section 141D of the Hong Kong Companies Ordinance requires that the balance sheet together with the notes thereon should be prepared in accordance with the requirements of the Eleventh Schedule to that Ordinance.]<sup>2</sup>

#### *Auditor's responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit<sup>3</sup>. Except as described in the basis for qualified opinion paragraph, we conducted our audit in accordance with Hong Kong Standards on Auditing and with reference to PN 900 (Revised) "Audit of Financial Statements Prepared in Accordance with the Small and Medium-sized Entity Financial Reporting Standard" issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to 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 entity's preparation and presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, 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.

---

<sup>1</sup> In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

<sup>2</sup> This additional wording is required for companies incorporated in Hong Kong applying section 141D of the Hong Kong Companies Ordinance

<sup>3</sup> Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".

*Basis for qualified opinion*

HK\$X of the Company's recorded turnover comprises cash sales, over which there was no system of internal control on which we could rely for the purpose of our audit. There were no other satisfactory audit procedures that we could adopt to satisfy ourselves that the recorded turnover was free from material misstatements.

*Qualified opinion arising from limitation of audit scope*

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to satisfy ourselves as to cash sales, the financial statements have been properly prepared, in all material respects, in accordance with the SME-FRS. [In addition, in our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to satisfy ourselves as to cash sales, the balance sheet together with the notes thereon is properly drawn up so as to exhibit a true and correct view of the state of the Company's affairs as at 31 December 200X according to the best of our information and explanations given to us, and as shown by the books of the Company.]<sup>2</sup>.

**Report on matters under sections 141(4), 141(6) and 141D of the Hong Kong Companies Ordinance**

In respect alone of the limitation on our work relating to cash sales:

- we have not obtained all the information and explanations that we considered necessary for the purpose of our audit; and
- we were unable to determine whether proper books of account had been kept.

XYZ & Co.

Certified Public Accountants (Practising) [or Certified Public Accountants]

[Address]

Date

### Example 3 – Disclaimer of opinion - limitation on the auditor’s work

## INDEPENDENT AUDITOR’S REPORT TO THE SHAREHOLDERS OF SME LIMITED

(incorporated in [country or place] with limited liability)<sup>1</sup>

### Report on the Financial Statements

We were engaged to audit the financial statements of SME Limited (the “Company”) set out on pages ..... to....., which comprise the balance sheet as at 31 December 200X, and the income statement, for the year then ended, and a summary of significant accounting policies and other explanatory notes.

#### *Directors’ responsibility for the financial statements*

The directors are responsible for the preparation and presentation of these financial statements in accordance with Small and Medium-sized Entity Financial Reporting Standard (SME-FRS) issued by the Hong Kong Institute of Certified Public Accountants. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

[In addition, section 141D of the Hong Kong Companies Ordinance requires that the balance sheet together with the notes thereon should be prepared in accordance with the requirements of the Eleventh Schedule to that Ordinance.]<sup>2</sup>

#### *Auditor’s responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit.<sup>3</sup> Except as described in the basis for disclaimer of opinion paragraph, we conducted our audit in accordance with Hong Kong Standards on Auditing and with reference to PN 900 (Revised) “Audit of Financial Statements Prepared in Accordance with the Small and Medium-sized Entity Financial Reporting Standard” issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement. However, because of the matter described in the basis for disclaimer of opinion paragraph, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

#### *Basis for disclaimer of opinion*

We were initially appointed auditors on (date) which was subsequent to the end of the Company’s financial year. In consequence we were unable to carry out auditing procedures necessary to obtain adequate assurance regarding the quantities and condition of inventories and work in progress, appearing in the balance sheet at HK\$X. There were no other satisfactory audit procedures that we could adopt to obtain sufficient evidence regarding the existence of inventories and work in progress. Accordingly, we have not been able to obtain sufficient appropriate audit evidence to provide a basis

---

<sup>1</sup> In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

<sup>2</sup> This additional wording is required for companies incorporated in Hong Kong applying section 141D of the Hong Kong Companies Ordinance

<sup>3</sup> Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 “Auditors’ Duty of Care To Third Parties and The Audit Report”.

for an audit opinion. Any adjustment to the figure may have a consequential significant effect on the profit [loss] for the year and net assets at 31 December 200X.

*Disclaimer of opinion: disclaimer on view given by financial statements<sup>4</sup>*

Because of the significance of the matters described in the basis for disclaimer of opinion paragraph, we do not express an opinion on the financial statements as to whether they have been properly prepared, in all material respects, in accordance with the SME-FRS. [In addition, we do not express an opinion on the balance sheet together with the notes thereon as to whether they are properly drawn up so as to exhibit a true and correct view of the state of the Company's affairs as at 31 December 200X according to the best of our information and explanations given to us, and as shown by the books of the Company.]<sup>2</sup>

### **Report on matters under sections 141(4), 141(6) and 141D of the Hong Kong Companies Ordinance**

In respect alone of the limitation on our work relating to inventories and work in progress:

- we have not obtained all the information and explanations that we considered necessary for the purpose of our audit; and
- we were unable to determine whether proper books of account had been kept.

XYZ & Co.

Certified Public Accountants (Practising) [or Certified Public Accountants]

[Address]

Date

---

<sup>4</sup> In this example, it is assumed that the counting of physical inventories is so material and pervasive that the auditor has not been able to obtain sufficient appropriate audit evidence and accordingly is unable to express an opinion on the financial statements. If the limitation of scope is not considered so material and pervasive, the auditor may express an "except for" opinion.

## Example 4 – Adverse opinion – disagreement with management

### INDEPENDENT AUDITOR’S REPORT

#### TO THE SHAREHOLDERS OF SME LIMITED

(incorporated in [country or place] with limited liability)<sup>1</sup>

#### Report on the Financial Statements

We have audited the financial statements of SME Limited (the “Company”) set out on pages ..... to....., which comprise the balance sheet as at 31 December 200X, and the income statement, for the year then ended, and a summary of significant accounting policies and other explanatory notes.

##### *Directors’ responsibility for the financial statements*

The directors are responsible for the preparation and presentation of these financial statements in accordance with Small and Medium-sized Entity Financial Reporting Standard (SME-FRS) issued by the Hong Kong Institute of Certified Public Accountants. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

[In addition, section 141D of the Hong Kong Companies Ordinance requires that the balance sheet together with the notes thereon should be prepared in accordance with the requirements of the Eleventh Schedule to that Ordinance.]<sup>2</sup>

##### *Auditor’s responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit<sup>3</sup>. We conducted our audit in accordance with Hong Kong Standards on Auditing and with reference to PN 900 (Revised) “Audit of Financial Statements Prepared in Accordance with the Small and Medium-sized Entity Financial Reporting Standard” issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to 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 entity’s preparation and presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, 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.

---

<sup>1</sup> In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

<sup>2</sup> This additional wording is required for companies incorporated in Hong Kong applying section 141D of the Hong Kong Companies Ordinance

<sup>3</sup> Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 “Auditors’ Duty of Care To Third Parties and The Audit Report”



*Basis for adverse opinion*

As more fully explained in note ... to the financial statements, losses expected to arise on certain long-term contracts currently in progress have not been recognised as expenses, as the directors consider that such losses should be off-set against amounts recoverable on other long-term contracts. In our opinion, the expected losses on individual contracts should be recognised as expenses immediately as required by Section 8 of the SME-FRS. If losses had been so recognised the effect would have been to [reduce the profit/increase the loss] before taxation for the year and reduce the gross amounts due from customers at 31 December 200X by HK\$X.

*Adverse opinion*

In our opinion, because of the significance of effects of the matters described in the basis for adverse opinion paragraph, the financial statements have not been properly prepared, in accordance with the SME-FRS. [In addition, in our opinion the balance sheet together with the notes thereon is not properly drawn up so as to exhibit a true and correct view of the state of the Company's affairs as at 31 December 200X according to the best of our information and explanations given to us, and as shown by the books of the Company.]<sup>2</sup>

**Report on other matters under section 141D of the Hong Kong Companies Ordinance**

[We report that we have obtained all the information and explanations which we have required.]<sup>2</sup>

XYZ & Co.

Certified Public Accountants (Practising) [or Certified Public Accountants]

[Address]

Date