



LIMITATION ON THE SCOPE OF THE AUDIT

GUIDE

Updated August 2021

This Guide was last updated in August 2021 and is based on the relevant laws and regulations that apply as at 1 August 2021.

Introduction

This Guide is designed to explain the main changes that are needed to the audit report when an auditor considers it necessary to issue a modified opinion on the financial statements due to a limitation on the scope of the audit.

The example chosen to illustrate the amendments needed to an unmodified opinion is where the auditor was appointed after the date of the inventory count and cannot obtain sufficient, appropriate audit evidence about the existence and condition of inventory by alternative means. The auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive. This assumes that aside from the matter giving rise to the qualified opinion, the auditor has obtained all other necessary evidence to support the opinion.

The example wording in this Guide has been adapted from the company examples in the [FRC's Bulletin: Illustrative auditor's reports on United Kingdom private sector financial statements](#) and the modified opinion examples in [ISA \(UK\) 705 Modifications to the Opinion in the Independent Auditor's Report](#).

For the purposes of this Guide, it has been presumed that the company is not required nor has chosen to prepare group financial statements. While the Guide comments on specific areas of the requirements for listed entities, Public Interest Entities, entities applying the UK Corporate Governance Code and other entities subject to the governance requirements of The Companies (Miscellaneous Reporting) Regulations 2018, it does not deal with all of the changes that would be required for those entities.

The Appendix also gives details of the impact of the qualification on subsequent years' audit reports.

Addressee of the report

No changes are required.

Qualified opinion

The opinion section is required to be headed up "Qualified opinion".

Even though there is a qualified opinion, it is important that the titles of the primary statements precisely match those used by the entity.

This section still needs to reflect whether the financial reporting framework is either UK GAAP (including either FRS 101 or 102) or IFRS.

The most important change is the wording of the qualified opinion itself to make clear that, except for the possible effects of the matter for which the auditor has been unable to obtain sufficient appropriate audit evidence, the auditor is able to provide an opinion on the financial statements.

Qualified opinion

We have audited the financial statements of [XYZ Limited] (the 'company') for the year ended [date] which comprise [specify the titles of the primary statements] and notes to the financial statements, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and [United Kingdom Accounting Standards, including [Financial Reporting Standard 101 Reduced Disclosure Framework / Financial Reporting Standard 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland] (United Kingdom Generally Accepted Accounting Practice) / international accounting standards in conformity with the requirements of the Companies Act 2006¹ / United Kingdom adopted International Financial Reporting Standards (IFRSs)²].

In our opinion, except for the possible effects of the matter described in the basis for qualified opinion section of our report, the financial statements:

- give a true and fair view of the state of the company's affairs as at [date] and of the company's [profit/loss] for the year then ended;
- have been properly prepared in accordance with [United Kingdom Generally Accepted Accounting Practice / international accounting standards in conformity with the requirements of the Companies Act 2006¹/ United Kingdom adopted International Financial Reporting Standards (IFRSs)²]; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for qualified opinion

The heading needs to be revised from "Basis for opinion" to read "Basis for qualified opinion".

This section needs to explain the specific reasons for the qualified opinion and make clear why the auditor was unable to obtain sufficient appropriate audit evidence and why the effect on the financial statements is material.

An example "Basis for qualified opinion" section, based on an auditor being appointed after the date of the inventory count is given below, but any section must be adapted to the specific circumstances of the entity.

Basis for qualified opinion

We were not appointed as auditor of the company until after 31 December 20X1 and thus did not observe the counting of physical inventories at the end of the year. We were unable to satisfy ourselves by alternative means concerning the inventory quantities held at 31 December 20X1, which are included in the balance sheet at £x, by using other audit procedures. Consequently we were unable to determine whether any adjustment to this amount was necessary.

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report. We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, and we

¹ For periods commencing before 1 January 2021.

² For periods commencing on or after 1 January 2021.

have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

Key audit matters

ISA (UK) 705 makes clear that for entities within the scope of ISA (UK) 701, the auditor is still required to include a key audit matters section even when issuing a qualified opinion.

The matter giving rise to the qualification is by its nature a key audit matter. However, this is not described in detail as part of the key audit matters section and the auditor needs to refer in that section to the basis for qualified opinion section of the audit report.

Key audit matters

...

In addition to the matter described in the basis for qualified opinion section, we have determined the matters described below to be the key audit matters to be communicated in our report.

...

If there are no other key audit matters, the following wording is used:

Key audit matters

Except for the matter described in the basis for qualified opinion section, we have determined that there are no key audit matters to be communicated in our report.

Conclusions relating to going concern

No changes are needed, assuming the qualification does not relate to going concern.

If the qualification relates to going concern, this section may be deleted as any relevant conclusions are likely to be included in the Basis for qualified opinion section.

Other information

In circumstances when the auditor's opinion is qualified, consideration may be given as to whether the other information is also impacted by the same matter as, or a related matter to, the matter giving rise to the qualified opinion on the financial statements.

The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information contained within the annual report.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether this gives rise to a material misstatement in the financial statements themselves. If, based on the

work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard. As described in the basis for qualified opinion section of our report, we were unable to satisfy ourselves concerning the inventory quantities of £x held at 31 December 20X1. We have concluded that where the other information refers to the inventory balance or related balances such as cost of sales, it may be materially misstated for the same reason.

Opinions on other matters prescribed by the Companies Act 2006

The auditor needs to consider whether the matter leading to the qualification also impacts the opinion on other matters prescribed by the Companies Act. If, for example, the strategic report refers to the inventory balance or indeed related balances such as costs of sales, working capital or net assets as stated in the financial statements, then while it may be consistent with the financial statements, the strategic report may not have been prepared in accordance with the applicable legal requirements if the inventory balance were to be materially misstated. The auditor may therefore need to qualify this section as well. As this is closely related to the matter described in the basis for qualified opinion section, it may be possible to add a separate sentence in that section rather than create a separate section called "Basis for qualified opinion on other matters prescribed by the Companies Act 2006":

We were not appointed as auditor of the company until after 31 December 20X1 and thus did not observe the counting of physical inventories at the end of the year. We were unable to satisfy ourselves by alternative means concerning the inventory quantities held at 31 December 20X1, which are included in the balance sheet at £x, by using other audit procedures.

Consequently we were unable to determine whether any adjustment to this amount was necessary. In addition, were any adjustment to the inventory balance to be required, the strategic report would also need to be amended.

The qualified opinion on other matters prescribed by the Companies Act 2006 could then also refer to that section:

Except for the possible effects of the matter described in the basis for qualified opinion section of our report, in our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

Matters on which the auditor is required to report by exception

The auditor is still required to report on certain matters by exception. As there is a qualified opinion arising from a limitation on the scope of the audit, it is expected that the auditor is unable to obtain all of the information and explanations required for the audit and unable to determine whether adequate accounting records have been kept.

There may be situations where the circumstances resulting in the limitation on the scope of the audit mean that the auditor concludes that adequate accounting records have not been kept (for example if the entity did not maintain any inventory records). In these situations, the conclusion "we were unable to determine whether adequate accounting records have been kept" would be replaced with "in our opinion, adequate accounting records have not been kept".

Further matters may also need to be reported – for example if the issue giving rise to the limitation on the scope of the audit related to some of the company's branches.

Assuming there are no such further issues, the wording is amended as follows:

Except for the matter described in the basis for qualified opinion section of our report, in the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified material misstatements in the strategic report or the directors' report.

Arising solely from the limitation on the scope of our work relating to inventory, referred to above:

- 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 adequate accounting records have been kept.

We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

- ~~adequate accounting records have not been kept, or~~ returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; ~~or we have not obtained all the information and explanations that we require for our audit.~~

Responsibilities of directors

No changes are needed.

Auditor's responsibilities for the audit of the financial statements

The only changes that may be needed are to the part explaining the extent to which the audit was capable of detecting irregularities, including fraud, if the limitation in scope related to the auditor's planned procedures in relation to fraud or laws and regulations. In such circumstances, the auditor may want to refer to the basis for qualified opinion section of the audit report.

Use of the audit report

No changes are needed to the guidance provided in Technical Release 01/03AAF (Revised), The Audit Report and Auditors' Duty of Care to Third Parties.

Signature on the audit report

The same requirements apply as if the audit report were unmodified.

Appendix – impact on the opinion in subsequent years

ISA (UK) 710 states that if the auditor's report on the prior period as previously issued included a qualified opinion and the matter which gave rise to the modification is unresolved, the auditor shall modify the auditor's opinion on the current period's financial statements. In the basis for qualified opinion paragraph the auditor shall either:

- a) *Refer to both the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material.*

This is likely to be the case in the subsequent year (20X2) following the non-attendance at the inventory count as any impact on the closing inventory balance for 20X1 is likely to affect the cost of sales in the subsequent year.

We were not appointed as auditor of the company until after 31 December 20X1 and thus did not observe the counting of physical inventories at the end of ~~the~~ that year. We were unable to satisfy ourselves by alternative means concerning the inventory quantities of £x held at 31 December 20X1 by using other audit procedures, which are included in the balance sheet at £x. Consequently we were unable to determine whether any adjustment to this amount at 31 December 20X1 was necessary or whether there was any consequential effect on the cost of sales for the year ended 31 December 20X2.

...

- b) *In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures.*

This is likely to be the case in for the second subsequent year (20X3), as the inventory balance for 20X1 which could not be audited still has a consequential impact on the cost of sales for 20X2.

The qualified opinion would refer to the possible effect on the corresponding figures only.

In our opinion, except for the possible effects on the corresponding figures of the matter described in the basis for qualified opinion section of our report, the financial statements:

- give a true and fair view of the state of the company's affairs as at [date] and of the company's [profit/loss] for the year then ended;
- have been properly prepared in accordance with [United Kingdom Generally Accepted Accounting Practice / international accounting standards in conformity with the requirements of the Companies Act 2006¹ / United Kingdom adopted International Financial Reporting Standards (IFRSs)²]; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

The basis for qualified opinion section would be amended as follows:

We were not appointed as auditor of the company until after 31 December 20X1 and thus did not observe the counting of physical inventories at the end of that year. We were unable to satisfy ourselves by alternative means concerning the inventory quantities of £x held at 31 December 20X1 by using other audit procedures. Consequently we were unable to determine ~~whether any adjustment to this amount at 31 December 20X1 was necessary or~~ whether there was any consequential effect on the cost of sales for the year ended 31 December 20X2. Our audit opinion on the financial statements for the period ended 31 December 20X2 was modified accordingly. Our opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures and the corresponding figures.

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* Source: CAW, 2020 – Interbrand, Best Global Brands 2019

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