

## 2 The UK professional framework

### 2.1 The relevant auditing standards

The legal requirements for audits in the United Kingdom are complemented by current professional standards, namely the International Standards on Auditing (UK) (ISAs), issued by the Financial Reporting Council (FRC). For accounting periods starting on or after 17 June 2016, the principal ISAs which deal with audit reports are:

- ISA 700 (Revised June 2016) *Forming an opinion and reporting on financial statements* (covered in this chapter);
- ISA 701 *Communicating key audit matters in the independent auditor's report* (this chapter);
- ISA 705 (Revised June 2016) *Modifications to the opinion in the independent auditor's report* (**chapter 3**);
- ISA 706 (Revised June 2016) *Emphasis of matter paragraphs and other matter paragraphs in the independent auditor's report* (**chapter 4**); and
- ISA 720 (Revised June 2016) *The auditor's responsibilities relating to other information* (**chapter 5**).

These revised standards replace the versions named below, which were covered in previous editions of this book and related to the UK and Ireland.

- ISA 700 *The auditor's report on financial statements* (covered in **chapter 2** of the previous edition);
- ISA 705 *Modifications to the opinion in the independent auditor's report* (**chapter 3**);
- ISA 706 *Emphasis of matter paragraphs and other matter paragraphs in the independent auditor's report* (**chapter 4**); and
- ISA 720:
  - *Section A: The auditor's responsibilities relating to other information in documents containing audited financial statements*; and
  - *Section B: The auditor's statutory reporting responsibilities in relation to directors' reports* (**chapter 5**).

The reasons for the revisions to these ISAs and other standards are:

- (a) **Implementation of EU legislation.** In April 2014, the European Parliament and the Council of the European Union issued Regulation EU/537/2014 covering specific requirements regarding statutory audit of public interest entities (PIEs) (the Regulation), and Directive 2014/56/EU covering the statutory audit of annual accounts and consolidated accounts (the Directive). Both apply with effect from 17 June 2016. The Regulation and Directive taken together require revisions to both the Ethical and Auditing Standards as well as changes to the UK Corporate Governance Code (the Code).

PIEs are defined by the Regulation and the Directive as:

- (a) entities governed by the law of a Member State whose transferable securities are admitted to trading on a regulated market of any Member State within the meaning of point 14 of Article 4(1) of Directive 2004/39/EC;

- (b) credit institutions as defined in point 1 of Article 3(1) of Directive 2013/36/EU of the European Parliament and of the Council (16), other than those referred to in Article 2 of that Directive;
- (c) insurance undertakings within the meaning of Article 2(1) of Directive 91/674/EEC; or
- (d) entities designated by Member States as public-interest entities, for instance undertakings that are of significant public relevance because of the nature of their business, their size or the number of their employees.

Broadly, (d) can be taken to include any entities which choose to apply the UK Corporate Governance Code.

Despite the vote on 23 June 2016 for the UK to leave the EU, this legislation continues to apply to the UK until it is repealed by the UK Parliament. This will not happen in the immediate future.

- (b) **Adoption of IAASB standards.** Up to now, all UK and Ireland ISAs have been virtually identical to those issued by the International Audit and Assurance Standards Board (IAASB) with the exception of ISA 700. In the light of changes made to ISA 700 by the IAASB to ensure that audit reports are more specific and informative, the FRC decided to align the UK version of this ISA with that issued by the IAASB – which meant a complete redrafting of ISA 700, the addition of ISA 701 and substantial revisions to ISAs 705, 706 and 720.

As before, these revised ISAs are in the ‘clarified’ form which became current for accounting periods ending on or after 15 December 2010. They all follow a similar format, with the statement of the standard at the beginning (Arabic numbered paragraphs), followed by application and other explanatory material (Paragraphs A1, A2, etc.). A conspicuous feature of the clarified ISAs is the use of ‘shall’ rather than ‘should’.

The Codes and Standards Team of the FRC are responsible for publishing and updating illustrative examples of audit reports, which were previously provided by the Auditing Practices Board (APB). Examples of audit reports from the APB Bulletin 2010/2 (still the current version) are in Part II of this book, sections A and B: these have been updated where necessary in accordance with the illustrative example of an audit report issued by the FRC in June 2013.

Four further examples of audit reports have been issued as an appendix to the revised ISA 700. These are reproduced at the end of Appendix A, and should be used as appropriate for reporting on entities with accounting periods starting on or after 17 June 2016.

Note that the Companies Act and other relevant Acts use the term ‘accounts’, reflecting the fundamental need for accountability to companies’ members and others dealing with them. The term used in auditing and accounting standards is ‘financial statements’.

Except where otherwise indicated, paragraph references in this chapter are to ISA 700 (revised June 2016).

## 2.2 Introduction, scope and objectives: ISA 700

Although the reporting standards have been completely rewritten, the structure and overall aim of each standard (scope, objectives, requirements) remain the same. It is worth remembering that (at least at the time of writing, summer 2016) the statutory requirements for audit in the UK are unchanged.

**Paragraph 1** clarifies that the ISA ‘deals with the auditor’s responsibility to form an opinion on the financial statements ... (and) with the form and content of the auditor’s report’.

**Paragraphs 2 and 3** outline the subject-matter of the other reporting standards (ISAs 701, 705 and 706) and confirm that ISA 700 applies to an audit of ‘general purpose financial statements’ (defined in paragraph 7 below).

**Paragraph 4** explains the global importance of consistency and comparability in audit reports, but also recognises the need for flexibility and ultimately '*credibility in the global marketplace*'.

After giving the effective date of accounting periods starting on or after 17 June 2016 (**paragraph 5**), the auditor's objectives in this ISA, set out in **paragraph 6**, are virtually identical to those of the previous ISA 700. These are:

- (a) to form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and
- (b) to express clearly that opinion through a written report.

## 2.3 Definitions

**Paragraphs 7–9** provide definitions of the financial reporting framework under which financial statements are prepared and reported on. Financial statements referred to in this ISA (and by implication other ISAs) are assumed to be 'general purpose' financial statements, designed to meet the common financial information needs of a wide range of users.

This general purpose framework (e.g. UK Generally Accepted Accounting Practice (UK GAAP) or International Financial Reporting Standards (IFRS)) may be a 'fair presentation framework' or a compliance framework'.

- A fair presentation framework (referred to in the previous ISA as a true and fair framework) is one which:
  - (i) *acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or*
  - (ii) *acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances. (A footnote here in ISA 700 says that this is often known as the 'true and fair override'. 'Fair presentation' is the IAASB expression for what is known, and required by law, in the UK as a 'true and fair view'.)*
- The term 'compliance framework' is used to refer to '*a financial reporting framework that requires compliance with the requirements of the framework, but does not contain the acknowledgements in (i) or (ii) above.*'

Finally, an 'unmodified opinion' is here defined as '*the opinion expressed by the auditor when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.*'

## 2.4 Forming an opinion

The first part of the Requirements section of ISA 700 (**paragraphs 10–15**) explains what the auditor must evaluate in order to reach an opinion in accordance with the applicable financial framework (described above).

First, there are two general evaluations – whether:

- there is sufficient evidence that the financial statements are free from material misstatements (whether due to fraud or error); and

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- the financial statements have been properly prepared in accordance with the relevant framework. This includes considering the quality of the client's accounting practices and looking for any indications of possible management bias.

Second, there are six specific evaluations – whether:

- the accounting policies are adequately disclosed, relevant and understandable;
- the accounting policies are appropriate and consistent with the relevant financial reporting framework;
- accounting estimates made by management are reasonable;
- the information in the financial statements is:
  - *relevant*
  - *reliable*
  - *comparable*
  - *understandable*
- the disclosures are enough to enable users to understand the effect of material transactions and events; and
- the terminology in the financial statements is appropriate.

### 2.5 Form of opinion

The basic principles governing the type of opinion that an auditor should express are promoted to their own section of the revised ISA. The aim is presumably to leave auditors in no doubt as to the importance of these principles.

**Paragraph 16** says that the auditor shall express an unmodified opinion – i.e. issue a 'clean' audit report – if the financial statements are prepared in accordance with the relevant framework. But an important addition to the ISA for the UK (which was also in the previous ISA 700) is included in this paragraph:

*In the UK, when expressing an unqualified opinion on financial statements prepared in accordance with a fair presentation framework it is not sufficient for the auditor to conclude that the financial statements give a true and fair view solely on the basis that the financial statements were prepared in accordance with accounting standards and any other applicable legal requirements.*

The legal background to the concepts of 'true and fair view' and 'properly prepared' has been covered in **chapter 1**, and the true and fair and compliance frameworks in **2.3** above. The FRC confirmed the importance, and the essentially unchanged nature, of 'true and fair' in a paper of that name issued in July 2011. The paper makes it clear that the principal element of the auditor's opinion is professional judgement:

*This professional judgement is all-important. It applies at all stages of preparation of the accounts, for example:*

- *Where there is a choice of accounting policies allowed under accounting standards, ensuring that those selected are appropriate (indeed, under UK GAAP, that they are the most appropriate), taking into account the circumstances of the company (see for example FRS 102 and IAS 8)*
- *Establishing accounting policies for items not specifically covered by accounting standards or where they are ambiguous. In such circumstances the approach in IAS 8 to consider standards*

*dealing with similar items may be appropriate; however reliance on an approved accounting treatment of a different kind of item will not necessarily give a true and fair view*

- *Making judgements, for example about valuation, aimed at giving a true and fair view*
- *Not using detailed accounting rules as an excuse for poor accounting*
- *Considering what is and what is not material*
- *Giving appropriate disclosures even where not specifically required by accounting standards*
- *Ensuring that significant information is not obscured by immaterial or irrelevant disclosures (see for example ASB Statement of Principles paragraph 3.29)*
- *Standing back at the end of the accounts process and making sure the accounts overall do give a true and fair view.*

The FRC paper does of course emphasise that in the vast majority of cases compliance with accounting standards will result in a true and fair view. The 'true and fair override' referred to in 2.3 above is used sparingly, and then more often than not where the issue concerned is not covered by a relevant standard.

**Paragraphs 17–19** deal with situations where an unmodified opinion may not be appropriate. If the audit evidence indicates that there are misstatements, or there is a lack of appropriate evidence, the auditor is referred to ISA 705 (see **chapter 3** below).

Where, despite following a relevant framework, the financial statements still do not 'achieve fair presentation' (i.e. give a true and fair view), the auditor is required to discuss this with management and then determine whether the report needs to be modified.

In the explanatory material to this ISA (paragraph A4c) there are some examples of situations where this discussion might be appropriate:

- The degree to which the amounts in the financial statements are aggregated or disaggregated, and whether the presentation of amounts or disclosures obscures useful information, or results in misleading information.
- Consistency with appropriate industry practice, or whether any departures are relevant to the entity's circumstances and therefore warranted.

## 2.6 Audit report – contents

After requiring (**paragraph 20**) that the report shall be in writing, ISA 700 sets out (**paragraphs 21–51**) the headings that it requires to appear in every audit report:

- Title
- Addressee
- Auditor's opinion
- Basis for opinion
- Going concern
- Key audit matters
- Other information
- Responsibilities for the financial statements
- Auditor's responsibilities

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- Other reporting responsibilities
- Name of the engagement partner, signature and address
- Date of the report
- Location of the auditor's office
- Auditor's signature

These will now be examined in turn.

### 2.6.1 Title

*The auditor's report shall have a title that clearly indicates that it is the report of an independent auditor. (paragraph 21)*

This is in order to distinguish the auditor's report from reports that might be issued by others, such as by those charged with governance, or from the reports of other auditors who may not have to comply with the FRC's Revised Ethical Standard.

It is worth noting that in the ISAs and the example reports in the current APB Bulletin the singular 'auditor's report' is used, although an audit firm might wish to refer to itself in the plural (auditors' report). This would be unlikely to cause a problem, but **leaving the apostrophe out altogether would be incorrect.**

### 2.6.2 Addressee

*The auditor's report shall be addressed as appropriate, based on the circumstances of the engagement. (paragraph 22)*

This goes to the heart of the report's objective, as the point of contact between auditors and members, proprietors or trustees. 'Members' is the term usually used for companies, as it can still be appropriate for companies without a share capital (e.g. those limited by guarantee).

The Companies Act requires the auditor to report to the company's members because the audit is undertaken on their behalf. Reports on other types of business are addressed as defined (as appropriate) by statute or the terms of the individual engagement.

If a company's name has changed during the accounting period or between the balance sheet date and the date of approval of the financial statements, the report should be addressed to 'the members of ABC Limited, formerly XYZ Limited'.

### 2.6.3 Auditor's opinion

*The first section of the auditor's report shall include the auditor's opinion, and shall have the heading 'Opinion' (paragraph 23).* This may look like a statement of the obvious, but the ISA is doubtless emphasising that in the new format of audit reports the opinion comes much nearer to the beginning of the report than hitherto.

**Paragraph 24** makes it clear that 'The Opinion section of the auditor's report shall also:

- (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 comprising the financial statements;
- (d) refer to the notes, including the summary of significant accounting policies; and

- (e) *specify the date of, or period covered by, each financial statement comprising the financial statements.*

As set out in 1.3 above, the statements required by law and accounting standards to be subject to audit are:

- the balance sheet (statement of financial position);
- the profit and loss account (statement of comprehensive income);
- the cash flow statement, unless exempted;
- the statement of total recognised gains and losses;
- the statement of movements in shareholders' funds (statement of changes in equity); and
- the supporting notes.

By 'identify' the ISA means that the above statements are listed by name in the introductory paragraph, although the APB Bulletin 2010/2 allows them to be referred to by page numbers if the financial statements are not published on a website or in PDF format.

Whilst the ISA as issued worldwide gives auditors the choice of using 'present fairly' and 'give a true and fair view', the additional text (for the UK) at the end of **paragraph 25**, mindful of the wording of the Companies Act, requires the latter. (If a compliance framework is being followed, adherence to this framework is substituted for the true and fair view.)

#### **2.6.4 Basis for opinion**

The basis for opinion follows the opinion section itself (**paragraph 28**). Four things must be covered; the report must include a section that:

- (a) *states that the audit was conducted in accordance with International Standards on Auditing (UK) and applicable law;*
- (b) *refers to the section of the auditor's report that describes the auditor's responsibilities under the ISAs (UK);*
- (c) *includes a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit, and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements [when identifying the relevant ethical requirements in the auditor's report, the auditor indicates that these include the FRC's Ethical Standard, applied as required];*
- (d) *states whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.*

This, together with the expanded section on the auditor's responsibilities, seems to be intended to replace the 'scope of the audit' section prescribed by the previous ISA. This information must be shown at this point in the audit report, with no alternative location; part of the section on the auditor's responsibilities may however be shown elsewhere (see 2.6.8 below).

The ethical responsibilities referred to can now be found in the FRC's Revised Ethical Standard 2016, which replaces the previous APB Ethical Standards.

#### **2.6.5 Going concern**

**Paragraph 29** simply states that the auditor shall report in compliance with the revised ISA 570 *Going Concern*. For further guidance related to going concern issues refer to 3.7.

## 7 Other statutory reports on accounts

### 7.1 Introduction

In addition to reporting on the accounts of a company under CA 2006, s. 495–497, auditors may be required to make an additional report in any of the following cases:

- if the company has prepared abbreviated accounts (**for accounting periods starting on or before 31 December 2015**: see 7.2 below);
- if the company has revised its accounts and/or directors' report where errors or omissions have been discovered after publication: see 7.4 below. (If the accounts or directors' report are revised, the auditors' report must also be revised.)

APB Bulletins 2008/4 and 2008/5 respectively give guidance on each of these subjects.

A new regime for small and medium-sized companies comes into force for accounting periods **starting** on or after 1 January 2016, as a result of the EU 2013 Directive on annual accounts, enacted in UK company law by the *Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015* (see 7.3 below).

CA 2006, s. 426 (as amended) states that companies may send to their members a copy of the strategic report (see 1.4 above) with 'supplementary material' instead of the full accounts. The auditor is not required to report on this, as the audit report on the full accounts already states whether the strategic report is consistent with the accounts.

This supplementary material must include statements as to whether:

- the audit report on the accounts was qualified or unqualified (if qualified, it must be set out in full); and
- the auditors' statement on the consistency of the strategic and directors' reports with the accounts was qualified or unqualified (if qualified, it must be set out in full).

### 7.2 Abbreviated accounts

For accounting periods starting on or before 31 December 2015, companies that qualify as small or medium-sized in relation to the financial year are entitled to exemptions in relation to the accounts that they submit to the Registrar of Companies for filing.

For accounting periods **starting** on or after 1 January 2016, this concession is withdrawn and replaced by new regulations: see 7.3 below.

The size and eligibility criteria for the exemptions are set out in CA 2006, s. 382–384. Sections 444 and 445 of the Act allow (respectively) small and medium-sized companies to file abbreviated accounts. The content of these is set out in the *Small Companies and Groups (Accounts and Directors' Reports) Regulations 2008* (SI 2008/409), Sch. 4.

The majority of abbreviated accounts are filed by small companies exempt from audit. If the directors of a company, which is not exempt from audit or does not take advantage of the exemption, wish to file abbreviated accounts, CA 2006, s. 449 requires the auditors to provide them with a report which states whether in their opinion:

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- the company is entitled to the exemptions; and
- the abbreviated accounts have been prepared in accordance with CA 2006, s. 444 or 445.

The auditors must also prepare an audit report on the full accounts which are to be laid before the members of the company. For the contents of this report, see APB Bulletin 2008/4.

### 7.3 New filing obligations – small and medium-sized companies

For accounting periods **starting** on or after 1 January 2016, small and medium-sized companies no longer have the option of filing abbreviated accounts with the Registrar of Companies. Instead they must file the same version of their accounts as they send to their members, with two provisos:

- small companies still have the option not to file their profit and loss account and directors' report; and
- small companies, other than charities, have the option to prepare for members, and file with the Registrar, **abridged accounts**; a company must also file a statement that all its members have consented to the abridgement.

Details of the content of abridged accounts are available on CCH Online.

The special report on abbreviated accounts will become redundant. At the time of writing (summer 2016), the FRC have not yet issued guidance on auditing and reporting of abridged accounts. For small companies which choose to have an audit (a minority), a standard audit report should be issued, with additional information about the audit report in the notes to the balance sheet if a profit and loss account is not filed.

The Government has legislated in 2016 to apply these changes to limited liability partnerships (the *Limited Liability Partnerships, Partnerships and Groups (Accounts and Audit) Regulations 2016* (SI 2016/575)).

### 7.4 Revised annual accounts and directors' reports

*Companies Act 2006*, s. 454 gives company directors the authority to revise annual accounts or directors' reports which do not comply with the Act. The only revisions permitted are those which are deemed necessary to correct errors in the original accounts and directors' report which caused the accounts or report not to comply with the Companies Act (or, where relevant, Article 4 of the IAS Regulation). The revision process does not arise if accounts are rejected by the Registrar of Companies and are returned for a technical amendment.

Sections 455 and 456 give the Secretary of State (for the department currently called the Department for Business, Innovation and Skills), or any person authorised by him, power to apply to the court for an order requiring the directors to revise defective accounts.

Procedures for the voluntary revision of accounts by the directors are set out in the *Companies (Revision of Defective Accounts and Report) Regulations 2008* (SI 2008/373).

The correction of annual accounts and directors' reports may be by:

- complete replacement; or
- the issue of a supplementary note.

The regulations contain no conditions which require one form or another of revision to be used. The directors may therefore use the form that is most appropriate to the circumstances leading to the revision.

In both instances, the accounts or directors' report are to be presented as if prepared and approved by the directors as at the date of the original accounts or directors' report. The auditor's report (see below) on the revised annual accounts or report is dated on the actual date when it is signed. It becomes the date of the audit report in place of the original date. If the company has prepared and filed abbreviated accounts, the directors must also consider the effect of the revision on those abbreviated accounts. They must file either a revised version of the abbreviated accounts or a statement that the revision of the full accounts does not affect the abbreviated accounts.

SI 2008/373, reg. 7 requires a company's auditor (normally the current auditor) to make a report to the company's members on any revised accounts prepared under s. 454 (voluntary revision). As regards revision under s. 455 and 456, the court makes any order it sees fit.

Bulletin 2008/5 advises that before issuing a report on revised accounts the auditor should:

- discover the reasons for the revision through discussion with those charged with governance;
- review relevant working papers to assess the context of the revision;
- consider the integrity of management and those charged with governance;
- obtain sufficient evidence to support the revisions; and
- consider any subsequent events which might prevent the auditor from signing a report on the revised accounts.

## 7.5 Examples of reports

Examples of the reports relevant to this chapter:

### Part II Section C, examples 4 and 5

4. Report on abbreviated accounts
5. Report on revised accounts

#### Source

Bulletin 2008/4

Bulletin 2008/5

## 8 Other reports under the Companies Act 2006

### 8.1 Introduction

This chapter covers reports that the *Companies Act 2006* requires auditors to produce in situations other than those already covered in previous chapters. In the order they appear in CA 2006 these are:

- s. 92 – re-registration of a company from private to public;
- s. 519 – auditor ceasing to hold office;
- s. 593 – public company allotting shares otherwise than for cash;
- s. 599 – transfer of non-cash assets by members to a public company;
- s. 714 – private company purchasing or redeeming shares out of capital; and
- s. 837 – statement on a company's ability to make a distribution where the audit report is qualified.

APB Bulletin 2008/9 gives guidance on each of these situations, which is summarised in this chapter.

Examples of each report are in **Part II Section C**.

### 8.2 Re-registration of a company from private to public

Under CA 2006, a private company may re-register as a public company if, among other things, it meets certain requirements regarding its net assets. The company's auditor is required:

- (a) to make a written statement regarding the net assets; and
- (b) to have issued a report on a balance sheet that is prepared at a date no more than seven months before application for re-registration is made to the Registrar of Companies, that is either:
  - (i) unqualified; or
  - (ii) qualified and the auditor expresses an opinion that the qualification is not material for determining the net assets of the company.

#### **Requirements as to net assets**

The *Companies Act 2006*, s. 92 requires a private company applying to re-register as a public company to obtain:

- a balance sheet of the company prepared as at a date not more than seven months before the date on which the application is delivered to the Registrar of Companies;
- an unqualified report by the company's auditor on that balance sheet; and
- a written statement by the company's auditor that, in its opinion, at the balance sheet date the amount of the company's net assets was not less than the aggregate of its called-up share capital and undistributable reserves. (The terms 'net assets' and 'undistributable reserves' have the same meaning as in CA 2006, s. 831 which deals with distribution of profit.)

Between the balance sheet date and the date on which the application for re-registration is delivered to the Registrar of Companies, there must be no change in the company's financial position that results in the amount of its net assets becoming less than the aggregate of its called-up share capital and undistributable reserves. As the auditor's statement is required to be made as at the balance sheet date, the auditor has no responsibility for the period between the balance sheet date and the date the application is delivered to the Registrar of Companies by the company.

#### **Meaning of unqualified report**

In the 2008 Bulletin, the word 'unqualified' is used to mean without material qualification: this equates to the meaning of 'modified' in ISA 705 (**chapter 3** above). Thus, an emphasis of matter statement accompanying an unmodified audit opinion would not invalidate the auditor's statement for the purpose of re-registration.

#### **The auditor's statement on net assets**

The auditor's statement required by CA 2006, s. 92(1)(c) is addressed to the company. With respect to the auditor's responsibility, the auditor's statement states that it is limited to an examination of the relationship between the company's net assets and its called-up share capital and undistributable reserves as stated in the audited balance sheet, so that it is clear that no further audit procedures have been carried out.

The statement by the auditor is dated when it is signed, which cannot be earlier than the date of the auditor's report on the balance sheet.

#### **The auditor's report on the balance sheet**

The *Companies Act* 2006, s. 92 requires that, for it to be 'unqualified', the auditor's report on the balance sheet must state without material qualification the auditor's opinion that the balance sheet has been properly prepared in accordance with the requirements of CA 2006. For a qualified report to be acceptable, the auditors are required to state in their report that the matter giving rise to the qualification is not material for determining (by reference to the balance sheet) whether at the balance sheet date the amount of the net assets of the company were not less than the aggregate of its called-up share capital and undistributable reserves.

The *Companies Act* does not require the auditor's report on the balance sheet and the auditor's statement on the net assets to be included within a combined report. However, as a practical matter, this will often be the most effective way for the auditor to report on these matters.

### **8.3 Auditor ceasing to hold office**

Note the change made by CA 2006 to the rule for quoted companies.

#### **Unquoted companies**

Where an auditor of an unquoted company ceases for any reason to hold office, it must deposit at the company's registered office either:

- a statement of the circumstances connected with it ceasing to hold office; or
- where it considers that there are no circumstances in connection with it ceasing to hold office that need to be brought to the attention of members or creditors of the company, a statement to that effect.

### Quoted companies

Where an auditor of a quoted company ceases for any reason to hold office, it must deposit at the company's registered office a statement of the circumstances connected with its ceasing to hold office. The auditor of a quoted company is not able to deposit a statement stating that there are no circumstances connected with it ceasing to hold office.

### Deadlines for filing the statement

The auditor's statement is required to be deposited:

- in the case of resignation along with the notice of resignation;
- in the case of failure to seek re-appointment, not less than 14 days before the end of the time allowed for next appointing an auditor;
- in any other case, not later than the end of the period of 14 days beginning with the date on which the auditor ceases to hold office.

'Quoted company' should be taken to mean a company whose equity share capital on the day of the audit cessation:

- has been included in the official list in accordance with the provisions of the *Financial Services and Markets Act 2000*, Pt. 6; or
- is officially listed in an EEA State; or
- is admitted to dealing on either the New York Stock Exchange or the exchange known as NASDAQ.

## 8.4 Public company allotting shares otherwise than for cash

The *Companies Act 2006*, s. 593 addresses the valuation of non-cash consideration for shares in a public company. Where a public company proposes to allot shares for such non-cash consideration it must, subject to certain exceptions, obtain during the six months before the date of the allotment a report on the value of the assets to be received in payment for the shares.

Sections 594 and 595 set out exceptions to the valuation requirement with respect to mergers and certain 'arrangements' with other companies.

Section 596 sets out the requirements as to the valuation and the report and in particular provides that the provisions of s. 1150–1153 should apply to the valuation and report required by s. 593. Under s. 1150, the valuation and the report must be made by a person who:

- (a) is eligible for appointment as a statutory auditor (see CA 2006, s. 1212); and
- (b) meets the independence requirement in CA 2006, s. 1151.

Thus, the 'valuer' may be the company's auditor or a similarly qualified independent accountant. However, where it appears to the valuer to be reasonable for the valuation of the consideration, or part of it, to be made by another person (an expert) the valuer may arrange for or accept such a valuation, together with a report which will enable him to make his own report.

If the company's own statutory auditor is requested to undertake a valuation in accordance with CA 2006, s. 593, the standards and guidance in APB Ethical Standard 5 (Revised) *Non-audit services provided to audited entities* are applied.

Guidance on the work to be carried out when relying on an expert is contained in ISA 620 *Using the work of an expert*. The expert must report to the valuer so as to enable the valuer to make its report.

The valuer's report will incorporate the following elements:

- (a) **Addressee** – the report is made to the company itself and sent to the company secretary for circulation to the proposed allottees.
- (b) **Introductory paragraph(s)** – in addition to expressing the opinion set out in (d) below, the report must include the following information:
  - (i) the nominal value of the shares to be wholly or partly paid for by the consideration in question;
  - (ii) the amount of any premium payable on the shares;
  - (iii) a description of the consideration;
  - (iv) a description of the part of the consideration valued by the valuer, the method used to value it and the date of the valuation; and
  - (v) the extent to which the nominal value of the shares and any premium are to be treated as paid up:
    - by the consideration; and
    - in cash.
- (c) **Basis of valuation** – the report indicates the basis of valuation of the consideration. If the valuation has been made by another person (i.e. an expert) the expert's name and relevant qualifications are stated in the basis of valuation. The basis of valuation also describes the part of the consideration valued by the expert, the method used to value it and specifies the date of the valuation.
- (d) **Opinion** – CA 2006, s. 596(3) requires that the valuer's report must contain, or be accompanied by, a note from the valuer, stating that:
  - (i) if the valuation has been made by an expert, it appears to be reasonable to arrange for it to be so made or to accept a valuation so made;
  - (ii) the method of valuation of the consideration was reasonable in all the circumstances;
  - (iii) there appears to have been no material change in the value of the consideration since the date at which the valuation was made; and
  - (iv) on the basis of the valuation, the value of the consideration, together with any cash by which the nominal value of the shares or any premium payable on them is to be paid up, is not less than so much of the aggregate of the nominal value and the whole of any such premium as is treated as paid up by the consideration and any such cash.
- (e) **Date** – the date used is the date on which the report is signed.

There is no provision for the report to be qualified. Unless the opinion is unqualified the valuer does not issue a report.

## 8.5 Transfer of non-cash assets by members to a public company

*Companies Act 2006*, s. 598 requires, among other things, that during the first two years following receipt of its trading certificate, a public company may not lawfully acquire from certain of its members (any subscriber to the memorandum) a non-cash asset for a consideration worth one-tenth or more of the company's issued share capital unless:

- the terms of the transfer have been approved by an ordinary resolution of the company (see CA 2006, s. 601); and
- a valuer's report has been made to the company within six months immediately preceding the date of the agreement to transfer the non-cash assets (see CA 2006, s. 599).

Under CA 2006, s. 1150, the valuation and the report must be made by a person who:

- is eligible for appointment as a statutory auditor (see CA 2006, s. 1212); and
- meets the independence requirement in CA 2006, s. 1151.

Thus, the 'valuer' may be the company's auditor or a similarly qualified independent accountant.

However, where it appears to the valuer to be reasonable for the valuation of the consideration to be made by another person (an expert), the valuer may arrange for or accept such a valuation, together with a report which will enable him to make his own report.

If the company's own statutory auditor is requested to undertake a valuation in accordance with CA 2006, s. 599, the standards and guidance in APB Ethical Standard 5 (Revised) *Non-audit services provided to audited entities* are applied.

Guidance on the work to be carried out when relying on an expert is contained in ISA 620 *Using the work of an expert*. The expert must report to the valuer so as to enable the valuer to make its own report.

The valuer's report will incorporate the following elements:

- (a) **Addressee** – the report is made to the company itself and sent to the company secretary for circulation to the members of the company and to the person selling the asset.
- (b) **Introductory paragraph(s)** – in addition to expressing the opinion set out in (d) below, the report must contain the following information:
  - (i) the consideration to be received by the company, describing the asset in question, and the consideration to be given by the company and specifying any amounts to be received or given in cash; and
  - (ii) the method and date of valuation.
- (c) **Basis of valuation** – the report indicates the basis of valuation of the consideration. If the valuation has been made by another person (i.e. an expert), the expert's name is stated in the basis of opinion as well as the knowledge and experience the expert has to carry out the valuation. The basis of opinion also describes the part of the consideration valued by the expert, the method used to value it and specifies the date of the valuation.
- (d) **Opinion** – the valuer must state that in its opinion:
  - (i) if the valuation has been made by an expert, it appears to be reasonable to accept or arrange for such a valuation;
  - (ii) the method of valuation was reasonable in all the circumstances;
  - (iii) there appears to have been no material change in the values of the asset in question since the date at which the valuation was made; and
  - (iv) on the basis of the valuation used, the value of the consideration to be received by the company is not less than the value of the consideration to be given by the company.
- (e) **Date** – the date used is that on which the report is signed.

There is no provision for the report to be qualified. Unless the opinion is unqualified the valuer does not issue a report.

## 8.6 Private company purchasing or redeeming shares out of capital

A payment out of capital by a private company for the redemption or purchase of its own shares is not lawful unless the requirements of CA 2006, s. 714, 716, 719, 720 and 721 are met. Section 716

requires that a payment out of capital must be approved by special resolution which must be passed on, or within the week immediately following, the date on which the directors make the statement required by s. 714.

#### **Directors' statement**

To make a payment out of capital, the directors are required by CA 2006, s. 714(1)–(5) to make a statement specifying the amount of the permissible capital payment for the shares in question. Section 714(3) requires the directors to state that, having made full inquiry into the affairs and prospects of the company, the directors have formed the opinion:

- (a) as regards its initial situation immediately following the date on which the payment out of capital is proposed to be made, that there will be no grounds on which the company could then be found unable to pay its debts; and
- (b) as regards its prospects for the year immediately following that date, that having regard to—
  - (i) their intentions with respect to the management of the company's business during that year; and
  - (ii) the amount and character of the financial resources that will in their view be available to the company during that year,

the company will be able to continue to carry on business as a going concern (and will accordingly be able to pay its debts as they fall due) throughout that year.

In forming their opinion, the directors are required to take into account all of the company's liabilities (including any contingent or prospective liabilities).

#### **The permissible capital payment (CA 2006, s. 710)**

The payment that may be made out of capital is described as the 'permissible capital payment' and is such amount as, after applying:

- (a) any available profits of the company; and
- (b) the proceeds of any fresh issue of shares made for the purposes of the redemption or purchase is required to meet the price of redemption or purchase.

Companies Act 2006, s. 711 and 712 give guidance on the determination of available profits.

#### **Report by the company's auditor**

The directors' statement is required by s. 714(6) to have annexed to it a report addressed to the directors by the company's auditor stating that:

- (a) it has inquired into the company's state of affairs;
- (b) the amount specified in the statement as the permissible capital payment for the shares in question is in its view properly determined in accordance with CA 2006, s. 710–712; and
- (c) it is not aware of anything to indicate that the opinion expressed by the directors in their statement is unreasonable in all the circumstances.

The directors' statement and therefore the annexed auditor's report are required to be made in the week before the resolution is passed specifying the amount of the permissible capital payment for the shares in question. The auditor's report cannot be dated earlier than the date of the director's statement to which it relates. The date of the auditor's report is the date on which the auditor signs its report expressing its opinion.

There is no provision for the auditor's report to be qualified. Unless the opinion is unqualified, the auditor does not issue a report.

### **8.7 Statement on a company's ability to make a distribution where the audit report is qualified**

The *Companies Act 2006*, s. 830(1) prohibits companies from making a distribution otherwise than out of profits available for that purpose.

Whether a distribution may be made by a company is determined by reference to the 'relevant accounts'. The relevant accounts are the company's last annual accounts (as defined in CA 2006, s. 837), except that:

- where the distribution would be found to contravene the requirements of CA 2006 by reference to the company's last annual accounts, the distribution may be justified by reference to **interim accounts**; and
- where the distribution is proposed to be declared during the company's first accounting reference period, or before any accounts have been circulated in respect of that period, the distribution may be justified by reference to **initial accounts**.

#### ***Requirements where the auditor has issued a qualified report on the last annual accounts***

Where the auditor has issued a qualified report on the last annual accounts, the company's ability to make a distribution, by reference to those accounts, could be in doubt. In such circumstances, the company may not proceed to make the distribution unless the auditor has made a statement under CA 2006, s. 837(4) as to whether, in the auditor's opinion, the matters in respect of which the auditor's report is qualified are material for determining whether a distribution would contravene the requirements of CA 2006, Pt. 23 (which deals with distributions).

The auditor's statement under CA 2006, s. 837(4) must be in writing and can be:

- (a) made in a separate statement which would be addressed to the members; or
- (b) included as a separate paragraph at the end of the auditor's report to the members on the accounts.

The auditor is required to state whether in its opinion the subject matter of the qualification is material for determining whether proposed distributions are permitted. A qualification is not material for this purpose if the financial effect of the matters giving rise to the qualification could not be such as to reduce the distributable profits below the levels required for the purpose of such distributions.

A report that expresses an unqualified opinion but includes an emphasis of matter or other matter paragraph is not regarded as being qualified.

Auditors should particularly note the potential effect on distributable profits of:

- moves towards fair value accounting as a result of applying FRS 102; and
- the encouragement by the FRC of greater disclosure of profits available for distribution.

#### ***Requirements where interim accounts used***

The *Companies Act 2006*, s. 838 establishes the requirements for making a distribution where interim accounts are used. In this circumstance, there are no requirements made of the company's auditor.

## PART II

### Example Reports

Part II consists of example reports. **Sections A and B** include the example reports from Bulletin 2010/2 (Revised) issued by the then Auditing Practices Board (which is still the current version). These examples have been fully updated to reflect the numerous changes in the requirements of both standards and legislation since the bulletin was last updated (but have not yet been updated for the June 2016 UK ISAs). **Section C** provides examples of accountants' reports from other sources.

**Note:** Where example reports include references to ISAs (UK and Ireland) these should be amended to ISAs (UK) where the June 2016 versions of ISAs are used.

Chapter references against each main heading are to the guidance in Part I of this book.

## Section A

### Examples of reports for companies

This section reproduces the part of Bulletin 2010/2 (Revised) which deals with companies. **Sections B and C** contain example reports on other business entities.

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<http://www.pbookshop.com>

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- *Company does not prepare group financial statements.*

#### **INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF XYZ LIMITED**

We have audited the financial statements of (name of company) for the year ended ... which comprise [specify the titles of the primary statements such as the Profit and Loss Account, the Balance Sheet, the Cash Flow Statement, the Statement of Total Recognised Gains and Losses, the Reconciliation of Movements in Shareholders' Funds] and the related notes.<sup>1</sup> The financial reporting framework that has been applied in their preparation is applicable law and the Financial Reporting Standard for Smaller Entities [(Effective April 2008)]<sup>2</sup> (United Kingdom Generally Accepted Accounting Practice applicable to Smaller Entities).

#### **Respective responsibilities of directors and auditor**

As explained more fully in the Directors' Responsibilities Statement [set out [on page ...]], the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's [(APB's)] Ethical Standards for Auditors[, including 'APB Ethical Standard-Provisions Available for Small Entities (Revised)'], in the circumstances set out in note [x] to the financial statements].<sup>3</sup>

#### **Scope of the audit of the financial statements**

Either:

A description of the scope of an audit of financial statements is [provided on the APB's website at [www.frc.org.uk/apb/scope/private.cfm](http://www.frc.org.uk/apb/scope/private.cfm)]/[set out [on page ...] of the Annual Report].

Or:

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the [describe the annual report] to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies, we consider the implications for our report.

<sup>1</sup> Auditor's reports of entities that do not publish their financial statements on a website or publish them using 'PDF' format may refer to the financial statements by reference to page numbers.

<sup>2</sup> Specify the version of The Financial Reporting Standard for Smaller Entities.

<sup>3</sup> Delete the words in square brackets if the relief and exemptions provided by ES PASE are not utilised. Paragraph 22 of ES PASE requires disclosure in the auditor's report where the audit firm has taken advantage of an exemption provided by ES PASE. The Appendix to ES PASE provides illustrative disclosures of relevant circumstances where the audit firm has taken advantage of an exemption provided by ES PASE.

### **Example 37 Qualified opinion: Disagreement – Inappropriate accounting treatment of debtors**

- UK non-publicly traded company prepares UK GAAP financial statements (Example 2).
- The debtors shown on the balance sheet include an amount of £Y due from a company which has ceased trading. XYZ Limited has no security for this debt.
- The auditor's opinion is that the company is unlikely to receive any payment and full provision of £Y should have been made.
- The auditor believes that the effect of the disagreement is material but not pervasive to the financial statements and accordingly issues a qualified opinion – except for disagreement about the accounting treatment of debtors.

#### **EXTRACT FROM AUDITOR'S REPORT**

...

#### **Basis for qualified opinion on financial statements**

Included in the debtors shown on the balance sheet is an amount of £Y due from a company which has ceased trading. XYZ Limited has no security for this debt. In our opinion, the company is unlikely to receive any payment and full provision of £Y should have been made. Accordingly, debtors should be reduced by £Y, the deferred tax liability should be reduced by £X and profit for the year and retained earnings should be reduced by £Z.

#### **Qualified opinion on financial statements**

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements:

- give a true and fair view of the state of the company's affairs as at ... and of its profit [loss] for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the *Companies Act 2006*.

#### **Opinion on other matter prescribed by the Companies Act 2006**

In our opinion, the information given in the Directors' Report and Strategic Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

#### **Matters on which we are required to report by exception<sup>53</sup>**

We have nothing to report in respect of the following matters where 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;
- the financial statements are not in agreement with the accounting records and returns;
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

<sup>53</sup> The auditor needs to consider whether the circumstances leading to the disagreement about the accounting treatment affect the matters on which the auditor is required to report by exception.

**Example 38 Qualified opinion: Disagreement – Non-disclosure of a going concern problem**

- *UK non-publicly traded company prepares UK GAAP financial statements (Example 2).*
- *The company's year-end is 31 December 20X1 and neither the financial statements nor the directors' report disclose that the Company's financing arrangements expire and amounts outstanding are payable on 19 July 20X2 and that the Company has been unable to re-negotiate or obtain replacement financing. The directors continue to talk to potential alternative providers of finance.*
- *This situation indicates the existence of a material uncertainty which may cast significant doubt on the company's ability to continue as a going concern and therefore it may be unable to realise its assets and discharge its liabilities in the normal course of business.*
- *The auditor concludes that there is a significant level of concern about going concern and disagrees with the failure to disclose this information in the financial statements. The auditor believes that the lack of disclosure although material is not pervasive to the financial statements and accordingly issues a qualified opinion describing the disagreement.*

**EXTRACT FROM AUDITOR'S REPORT**

...

***Basis for qualified opinion on financial statements***

The company's financing arrangements expire and amounts outstanding are payable on 19 July 20X2. While the directors continue to investigate alternative sources of finance, the company has so far been unable to re-negotiate or obtain replacement financing. This situation indicates the existence of a material uncertainty which may cast significant doubt on the company's ability to continue as a going concern and therefore it may be unable to realise its assets and discharge its liabilities in the normal course of business. The financial statements (and notes thereto) do not disclose this fact.

***Qualified opinion on financial statements***

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 20X1 and of its profit [loss] for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the *Companies Act 2006*.

***Opinion on other matter prescribed by the Companies Act 2006***

...

**Example 39 Qualified opinion: Disagreement – Non-disclosure of information required to be disclosed**

- UK non-publicly traded company prepares UK GAAP financial statements (Example 2).
- The company has not disclosed that one of its bankers has a fixed and floating charge over all of the company's assets as security for a long term loan. Such disclosure is required by paragraph 61 of Part 2 to Schedule 1 of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

**EXTRACT FROM AUDITOR'S REPORT**

...

**Basis for qualified opinion on financial statements**

The notes to the financial statements do not disclose that one of the company's bankers has a fixed and floating charge over all of the company's assets as security for a bank loan of £5m which is included in creditors: amounts falling due after more than one year. Such disclosure is required by the *Companies Act 2006*.

**Qualified opinion on financial statements**

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 20X1 and of its profit [loss] for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the *Companies Act 2006*.

**Opinion on other matter prescribed by the Companies Act 2006**

...