

What Is an Auditor's Report?

The auditor's report is a document containing the auditor's opinion on whether a company's financial statements comply with GAAP and are free from material misstatement.

- The audit report is important because banks, creditors, and regulators require an audit of a company's financial statements.
- A clean audit report means a company followed accounting standards while an unqualified report means there might be errors.
- An adverse report means that the financial statements might have had discrepancies, misrepresentations, and didn't adhere to GAAP.

Auditor is responsible to issue Auditor's report. The auditor should be careful in issuing the audit report as there is a large number of people placing reliance on such report and taking decisions accordingly. The report should be issued by being unbiased and objective in discharging the functions.

Contents of an Audit Report

The basic structure of an audit report as prescribed by the Standards on Auditing is as follows:

Heading	Brief of contents
Title	Title should mention that it is an 'Independent Auditor's Report'.
Addressee	Should mention clearly as to whom the report is being given to. For example Members of the company, Board of Directors

Management's Responsibility for Financial Statements	Mentions that it is the Management's responsibility to Prepare the Financial Statements.
Auditor's Responsibility	Mention that responsibility of the Auditor is to express an unbiased opinion on the financial statements and issue an audit report.
Opinion	Should mention the overall impression obtained from the audit of financial statements. For example Modified Opinion, Unmodified Opinion
Basis of the Opinion	State the basis on which the opinion as reported has been achieved. Facts of the basis should be mentioned.
Other Reporting Responsibility	If any other reporting responsibility exists, the same should be mentioned. For example Report on Legal or Regulatory requirements
Signature of the Auditor	The engagement partner (auditor) shall sign the audit report.
Place of Signature	The city in which audit report is signed.

Date of Audit Report	Date on which the audit report is signed.
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We need to understand about the opinion part precisely. This part forms the basic crux of an audit report.

Opinion in an Audit Report

There are primarily two kinds of opinions issued by an auditor in his / her audit report:

Unmodified Opinion (***also called Unqualified report***)

Modified Opinion (***also called Qualified report***)

Unmodified Opinion

Issued for any audit where the auditor is satisfied that the financial statements present a true and fair view of the operations and transactions in an enterprise during the period. An audit report with an Unmodified Opinion is also known as a 'Clean Report'. An Unmodified report develops confidence among users of Financial statements and annual reports of an enterprise. It provides an impression that the financial statements are reasonably free from any misstatements and results as appearing there are true and fair.

Modified Opinion

Whenever the auditor has specific findings during his / her audit and concludes that an Unmodified Opinion cannot be issued due to the nature of findings, a *Modified Opinion* is issued in the audit report. There are two basic reasons due to which an auditor concludes on issuing a Modified Opinion:

Based on the audit and evidence, finds out that the financial statements contain a certain degree of material misstatements.

Unable to obtain sufficient and appropriate evidences to conclude that the financial statements are free from material misstatements.

There are three kinds of modified opinions which are issued according to the findings and circumstances:

Adverse Opinion

Qualified Opinion

Disclaimer of Opinion

Qualified Opinion

A Qualified Opinion is given in a situation where:

The auditor concludes that misstatements are material but the impact is not so high that it would render the whole financial statements unacceptable; or

The auditor is unable to obtain sufficient or appropriate audit evidence but concludes that there are indications of misstatements in the financial statements (but the degree is not high).

Example of a Qualified Opinion paragraph in audit report:

In our opinion, except for the incomplete disclosure of the information referred to in the Basis for Qualified Opinion paragraph, the financial statements give the information required by the Companies Act, 2013, in the manner so required and give a true and fair view in conformity with the accounting principles generally accepted in India:

In case of the Balance Sheet, of the state of affairs of the company as at March 31, XXXX;

In case of Profit and Loss Account, of the profit/loss for the year ended on that date; and

In case of the Cash Flow Statement, of the cash flows for the year ended on that date.

Adverse Opinion

An Adverse opinion shall be issued by the auditor where he concludes that on the basis of evidence obtained and procedures performed, there are material misstatements in the financial statements and the impact of the same is high.

Example of a Qualified Opinion paragraph in audit report:

In our opinion, because of the omission of the information in the Basis for Adverse Opinion paragraph, the financial statements do not give the information required by the Companies Act, 2013, in the manner so required and also, do not give a true and fair view in conformity with the accounting principles generally accepted in India:

In case of the Balance Sheet, of the state of affairs of the company as at March 31, XXXX;

In case of Profit and Loss Account, of the profit/loss for the year ended on that date; and

In case of the Cash Flow Statement, of the cash flows for the year ended on that date.

Disclaimer of Opinion

A Disclaimer of Opinion is to be issued by an auditor in cases where the auditor concludes that he / she is not able to obtain sufficient and appropriate evidences. In such scenario, the auditor is not able to form an opinion and thus, disclaims from providing an opinion on the financial statements. The impact of material misstatements and degree of the same is high enough.

Example of a Draft Disclaimer of Opinion: We were engaged to audit the financial statements of ABC Private Limited ("the entity") which comprises the Balance Sheet as at March 31, XXXX, the statement of Profit and Loss, (the statement of changes in equity) and statement of Cash Flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies. We do not express an opinion on the accompanying financial statements of the entity. Because of the significance of the matters described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient and appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

Emphasis of Matter paragraph in an Audit Report

In a situation where the auditor concludes that it is important to draw the attention of users of the financial statement to a particular reported item, he/she may include an *Emphasis of Matter* paragraph in his / her audit report. In this case, the auditor is not required to modify his / her opinion. The paragraph is added when the issue is not a key audit matter and only requires disclosure for a better understanding of the financial statements.

Example of circumstances where the auditor shall include Emphasis of Matter paragraph in audit report:

To inform users of financial statements that the same has been prepared under a special purpose framework;

The auditor discovers some facts after the date of an audit report and the auditor issues new or amended audit report.

Uncertainty about the future outcome of an ongoing litigation.

Draft Format of Directors' Report :

Financial reporting is necessary for companies as it provides details of the state of a company and its compliance with financial, corporate social responsibility and accounting standards. Public and private limited companies must file a financial document called the directors' report at the end of the financial year. The directors' report is the report prepared by the Board of Directors of the company and should be attached to every financial statement. It outlines the financial state of the company.

Applicability of the Directors' Report

All companies need to prepare the directors' report, except One Person Company (OPC) and small companies. The small companies and OPCs need to file the abridged directors' report as per Rule 8A of the Companies (Accounts) Amendment Rules, 2018.

Purpose of the Director's Report

Under Section 134(3) of the Companies Act, 2013, the directors of a company must prepare the directors' report at the end of each financial year. The boards' report or the directors' report ensures greater corporate transparency. The shareholders can make informed decisions through the directors' report's information. The information provided in the directors' report helps shareholders to understand:

- Whether the company can grow and expand
- Whether the finances of the company are in good health
- How the company is performing within its market and how the market is performing in general
- Whether the company is complying with accounting standards, financial regulations, and corporate social responsibility requirements

Contents of a Director's Report

Section 134(3) of the Companies Act, 2013 and Rule 8 of the Companies (Accounts) Rules, 2014 provides the information that needs to be provided in the directors' report. The listed companies must add additional disclosures provided under Rule 5 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, in their directors' report.

Contents of a Directors' Report as per Companies Act, 2013

According to Section 134(3) of the Companies Act, 2013 ('Act'), the board's report should include the following information:

- The annual return extract as provided under Section 92(3) of the Act
- Number of board meetings
- Directors' responsibility statement as prescribed under Section 134(5) of the Act

- Details regarding frauds reported by auditors under Section 143(12) of the Act other than those reportable to the Central Government
- Statement of the declaration provided by independent directors under Section 149(6) of the Act
- Comments or explanations by the board on every reservation, qualification, or adverse disclaimer or remark made by the auditor in their report and by the company secretary in practice in their secretarial audit report
- Particulars of guarantees, loans or investments made under Section 186 of the Act
- Particulars of arrangements or contracts with related parties as prescribed under Section 188(1) of the Act
- The state of the company's affairs
- The amounts that the company proposes to carry to any reserves if any
- The amount that the company recommends should be paid by way of dividend if any
- Material commitments and changes affecting the financial position of the company occurred between the end of the financial year to which the financial statements relate and the date of the report if any
- The conservation of technology absorption, energy, outgo and foreign exchange earnings, in the manner provided in Rule 8(3) of the Companies (Accounts) Rules, 2014

- A statement indicating implementation and development of a risk management policy including identification of risk elements, which, in the boards' opinion, may threaten the company existence, if any
- The details about the policy implemented and developed by the company on Corporate Social Responsibility (CSR) initiatives undertaken during the year
- A statement indicating how the board has made the formal annual evaluation of its own performance, its committees and individual directors in the case of listed companies and every other public company having paid-up share capital of Rs.25 crore or more calculated at the end of the previous financial year
- Such other matters as may be prescribed

Contents of a Directors' Report as per Companies (Accounts) Rules, 2014

Rule 8 of the Companies (Accounts) Rules, 2014, provides that the board's report should include the following information:

- The directors must prepare the board's report on the basis of stand-alone financial statements of the company
- The directors' report must contain a separate section where a report on the financial position and performance of all associates, subsidiaries, and joint venture companies included in the consolidated financial statements is presented.

- The following are the details relating to the conservation of energy:

- The impact or steps taken on the conservation of energy
- The steps taken for the usage of alternate sources of energy
- The capital investment in energy conservation equipment
- Contents of boards' report as per Companies Act, 2013

- The following are the details relating to technology absorption:

- The efforts made towards technology absorption
- The benefits derived like cost reduction, product development, product improvement, or import substitution
- In the case of imported technology, i.e. imported during the previous three years, details of technology imported, year of import, whether the technology has been fully absorbed and the areas and reasons where absorption has not taken place
- The expenditure incurred on research and development

- The earned foreign exchange in terms of actual inflows during the year
- The outgo foreign exchange during the year in terms of actual outflows
- The financial highlights or summary
- Any changes in the nature of business
- The details of key managerial personnel or directors who were appointed or resigned during the year
- The names of companies that have ceased or become its joint ventures, subsidiaries, or associate companies during the year

- The following details relating to:

- Deposits accepted during the year
- Unpaid deposits or unclaimed deposits at the end of the year
- Default in payment or repayment of deposits or payment of interest during the year, number of such default and the total amount involved at the beginning of the year, maximum during the year and at the end of the year

- Details of deposits that are not in compliance with the requirements of Chapter V of the Act
- The details of material and significant orders passed by the regulators, tribunals or courts impacting the company's operations in future and going concern status
- The details regarding the adequacy of internal financial controls concerning the financial statements

Additional Contents of a Directors' Report for Listing Companies

Section 197(12) of the Companies Act, 2013, prescribes that the listed companies should disclose the remuneration ratio of all directors to the median employee's remuneration and such other details in the board's report.

According to Rule 5 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the board's report should include the following information:

- The increase in the percentage of the remuneration of each chief financial officer, director, chief executive officer, manager, or company secretary in the financial year, if any
- The increase in the percentage in the median remuneration of the employees in the financial year
- The number of permanent employees on the rolls of the company
- The explanation on the relationship between company performance and an average increase in remuneration
- Comparison of the remuneration of the KMP (Key Managerial Personnel) against the performance of the company
- Variations in the company's market capitalisation and price-earnings ratio as on the closing date of the current financial year and previous financial year
- Average percentile increase made in the employees' salaries other than the managerial personnel in the previous financial year
- The key parameters for variable components of remuneration availed by the directors
- The remuneration ratio of the highest paid director to that of the employees who are not directors but receive remuneration above the highest paid director during the year

- Affirmation that the remuneration is according to the remuneration policy of the company
- A statement consisting the name of every employee of the company indicating the following:

- Designation of the employee
- Remuneration
- Nature of employment, whether contractual or otherwise
- Experience and qualifications of the employee
- Date of commencement of employment
- Age of the employee
- The last employment held by the employee before joining the company
- The equity shares percentage held by the employee in the company
- Whether such employee is a relative of manager or director of the company and name of such manager or director

Penalty for not Preparing the Directors' Report

The board's report or Directors' report and its annexures should be signed by the company's chairperson when the board authorises them. When the board does not authorise the company's chairperson for signing the report, at least two directors should sign the report, one of whom must be a

managing director. A signed copy of the directors' report should be circulated, issued or published on the company website.

When a company defaults in the preparation of the board's report and directors' report, the company has to pay a penalty of Rs.3 lakh, and every officer of the company in default has to pay a penalty of Rs.50,000.

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