auditblog

The Kiwi guide to audit reports

Sometimes auditors seem to speak another language. Here's an attempt to translate some auditor-speak into Kiwi-speak...

Ever wondered what makes an editor blush? For me, it's editing the Auditor-General's reports on audit results and failing to explain the audit reports properly. A public museum somewhere was given an "adverse audit opinion", and maybe some schools' audit opinions had the words "disclaimer of opinion" in them. Is that bad? Which is worse? And what's a "qualified opinion", anyway? One that went to university?

The words are probably clear enough, but every time it feels like we haven't made it clear what those audit opinions actually mean. So here's a crack at getting the rosy glow off my cheeks.

We all pay taxes, and many of us pay rates, too. We've got a right to know that our money is being spent wisely. When we want that reassurance, we can take a look at the annual reports of the organisations spending our money. But how do we know that the information in the annual reports is reliable?

Well, if you're talking absolute reassurance, auditors can't give you that. But some of what goes into that annual report has to be considered by an independent and sceptical auditor – and that's where the audit report comes in. The audit report is for all of us – a guide for the reader about the reliability of the information in the annual report.

The audit report says whether you can rely on information that's gone into the financial statements in the annual report – the pages and pages of dense tables of numbers and tiny little text that many of us don't take the time to read or don't understand. And the auditor gives their opinion on the service performance information, too. They're the important bits, really – the claims made by the entity about how the money from our taxes and rates was used and what we, as taxpayers and ratepayers, supposedly got out of it. What difference has it made?

The person giving the audit opinion won't have looked at everything, but they understand finances a lot better than most of us ever will. For many annual reports, they'll also offer an opinion about whether bits of that annual report are reporting the right sort of information about the services being provided. For example, is the local district health board telling us how many staff or beds it has, when we'd rather know how many operations it's providing and how it measures trends in patient safety? And how has the cost of those operations changed over time?

When the auditor gives their audit opinion, they use auditing expressions that come from international standards and conventions. Here's an attempt at translating them...

"Nice one, Stu!"

Getting a standard audit report with an **unmodified audit opinion** is like getting a smiley-face stamp. The auditor didn't spot anything that raised an eyebrow or needed pointing out to the reader.

In the auditor's view, the information they looked at is a fair reflection of what actually happened. And that information is in keeping with the many, many practices (we're not supposed to call them rules – that's a whole 'nother blog post) on how to set out the financial statements.

Makes me glad I work with words.

If the auditor didn't say "Nice one, Stu!", then they issued some form of non-standard audit report. A non-standard audit report can range from the equivalent of throwing your hands up in the air and walking away through to highlighting a specific matter for the readers.

This guide was previously published at blog.oag.govt.nz/answering-questions/kiwi-guide

Yeah, right

An adverse opinion is the worst. It's the baddest of the bad in non-standard audit opinions.

It means that the organisation put something in the annual report that made the auditor think "I don't think so!". It's a serious disagreement between the organisation and the auditor.

The adverse opinion is like the klaxons sounding – the reader should not be relying on the content to give them a solid view of the organisation's finances or what it has delivered in services to the public.

When you see an adverse opinion, the auditor will often use words like "material misstatement" and "pervasive".

Whatever it is that hasn't been reported properly in the financial statements, **material** means that it's big enough to matter and pervasive is even bigger. There is no hard-and-fast rule about how much money counts as material – it all depends on how much money that organisation is dealing with. Material for some is small change to others.

Pervasive means that it isn't an isolated problem – it affects so much that the information that's been reported, as a whole, is misleading.

Yeah, nah

When the audit opinion uses the words **disclaimer of opinion,** that's a "yeah, nah" result. Yes, entity, nice try at fairly reflecting what has been happening, but no. The auditor can't give it a clean bill of health, because they couldn't do everything they needed to do.

It often means that the entity couldn't provide the auditor with enough evidence about something, and that has limited the scope of the audit.

While an adverse opinion is material and pervasive, a disclaimer of opinion is pervasive – it affects a lot of the information. It's likely to be material, too – but that limitation-in-scope thing means that the auditor can't really tell whether the information is reliable.

Yeah, but

When the audit opinion is **qualified**, it means something different again. This time, whatever it is that the auditor disagrees with, it's material – it matters – but it isn't pervasive. So the audit report is saying "yes, this information does fairly reflect what the organisation has been doing and how it has used our taxes or rates – but ..."

Sometimes, the auditor has got all the evidence they need and concludes that the content that isn't stated right (called "misstatements"), individually or together, is material but not pervasive. The auditor could have concerns about the pages of financial information or the information about how well the organisation performed in providing people with services, or both.

Other times, the auditor hasn't been given or found enough evidence, and the information that's missing could make a difference to a reader's understanding of the audited bits of what's in the annual report. It could be material, but the auditor doesn't think it's pervasive and they say "we've got all the evidence we need except ..."

Yeah, and

Regardless of whether any of the stuff above has happened, the auditor can emphasise something – draw the reader's attention to something that's important to how the reader understands what's in the audited bits of that annual report.

An **emphasis-of-matter paragraph** in the audit report doesn't mean that anything's wrong, but if you're reading the annual report then you ought to know about whatever the auditor's drawing attention to.

The emphasis-of-matter paragraph is the auditor's way of calling out "Hey, reader! Make sure you take a note of this."

It's pretty common for the words "going concern" to crop up here. The auditor might give the "Nice one, Stu!" opinion – an unmodified opinion – and add in an emphasis-of-matter paragraph because the organisation is dependent on the continuing support of its bankers.

If the organisation is in a position to carry on, then all the financial information is put together assuming that the business is a "going concern". If it's winding up, then the folks preparing that financial information should not use the going-concern assumption.

There's one other sort of paragraph that the auditor can use – the "other matter" paragraph. The auditor can include an **other-matter paragraph** if something isn't quite in keeping with the auditor's expectations or isn't made clear enough to the reader.

Whatever it is, it's something that, in the auditor's professional judgement, is relevant to a reader's understanding of the financial and/or service performance information but hasn't been highlighted by the entity in its annual report.

This has been a bit of a rough and ready guide, but did it help? If you're interested in a more technical explanation please check out some of what we've formally published.