# THE AUDITOR’S REPORT ON FINANCIAL STATEMENTS

**SRI LANKA AUDITING STANDARD 700**

**THE AUDITOR’S REPORT ON FINANCIAL STATEMENTS**

(Effective for all the audits carried out on or after …………………..)

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Introduction

1. The purpose of this Sri Lanka Auditing Standard (SLAuS) is to establish standards and provide guidance on the form and content of the auditor’s report issued as a result of an audit performed by an independent auditor of the financial statements of an entity. Much of the guidance provided can be adapted to auditor’s reports on financial information other than financial statements.

2. The auditor should review and assess the conclusions drawn from the audit evidence obtained as the basis for the expression of an opinion on the financial statements.

3. This review and assessment involves considering whether the financial statements have been prepared in accordance with an acceptable financial reporting framework being Sri Lanka Accounting Standards (SLASs) or relevant other standards or practices. It may also be necessary to consider whether the financial statements comply with statutory requirements.

4. The auditor’s report should contain a clear written expression of opinion on the financial statements taken as a whole.

Basic Elements of the Auditor’s Report

5. The auditor’s report includes the following basic elements, ordinarily in the following layout:

   (a) Title;
   (b) Addressee;
   (c) Opening or introductory paragraph
      (i) Identification of the financial statements audited;
      (ii) A statement of the responsibility of the entity’s management and the responsibility of the auditor;
   (d) Scope paragraph (describing the nature of an audit)
      (i) A reference to the SLAuSs or relevant other standards or practices;
      (ii) Basis of Opinion and a description of the work the auditor performed;
   (e) Opinion paragraph containing
(i) A reference to the financial reporting framework used to prepare the financial statements (including identifying the country of origin\(^1\) of the financial reporting framework when the framework used is not Sri Lanka Accounting Standards); and

(ii) An expression of opinion on the financial statements;

(f) Date of the report;

(g) Auditor’s address; and

(h) Auditor’s signature.

A measure of uniformity in the form and content of the auditor’s report is desirable because it helps to promote the reader’s understanding and to identify unusual circumstances when they occur.

**Title**

6. **The auditor’s report should have an appropriate title.** It may be appropriate to use the term “Independent Auditor” in the title to distinguish the auditor’s report from reports that might be issued by others, such as by officers of the entity, the board of directors, or from the reports of other auditors who may not have to abide by the same ethical requirements as the independent auditor.

**Addressee**

7. **The auditor’s report should be appropriately addressed as required by the circumstances of the engagement and local regulations.** The report is ordinarily addressed either to the shareholders or the board of directors of the entity whose financial statements are being audited.

**Opening or Introductory Paragraph**

8. **The auditor’s report should identify the financial statements of the entity that have been audited, including the date of and period covered by the financial statements.**

9. **The report should include a statement that the financial statements are the responsibility of the entity’s management\(^2\) and a statement that the responsibility of the auditor is to express an opinion on the financial statements based on the audit.**

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\(^1\) In some circumstances it also may be necessary to refer to a particular jurisdiction within the country of origin to identify clearly the financial reporting framework used.

\(^2\) The level of management responsible for the financial statements will vary according to the statutory requirements.
10. Financial statements are the representations of management. The preparation of such statements requires management to make significant accounting estimates and judgments, as well as to determine the appropriate accounting principles and methods used in preparation of the financial statements. This determination will be made in the context of the financial reporting framework that management chooses, or is required, to use. In contrast, the auditor’s responsibility is to audit these financial statements in order to express an opinion thereon.

11. An illustration of these matters in an opening (introductory) paragraph is:

“We have audited the accompanying financial statements of ABC Company, which comprise the balance sheet as at March 31, 20X9, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Accounting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.”

Scope Paragraph

12. The auditor’s report should describe the scope of the audit by stating that the audit was conducted in accordance with SLAuSs. “Scope” refers to the auditor’s ability to perform audit procedures deemed necessary in the circumstances. The reader needs this as an assurance that the audit has been carried out in accordance with established standards or practices. Unless otherwise stated, the auditing standards or practices followed are presumed to be those of the country indicated by the auditor’s address.

13. The report should include a statement that the audit was planned and performed to obtain reasonable assurance about whether the financial statements are free of material misstatement.

14. The auditor’s report should describe the audit as including:

(a) Examining, on a test basis, evidence to support the financial statement amounts and disclosures;

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3 The reference can be by page numbers.

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(b) Assessing the accounting policies used in the preparation of the financial statements;

(c) Assessing the significant estimates made by management in the preparation of the financial statements;

(d) Evaluating the overall financial statement presentation; and

(e) Obtaining all the information & explanations which to the best of the auditor’s knowledge and belief were necessary for the purposes of the audit.

15. The report should include a statement by the auditor that the audit provides a reasonable basis for the opinion.

16. An illustration of these matters in a scope paragraph is:

“Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Sri Lanka Auditing Standards. Those standards require that we plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting policies used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

We have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our audit. We therefore believe that our audit provides a reasonable basis for our opinion.”

Opinion Paragraph

17. The opinion paragraph of the auditor’s report should clearly indicate the financial reporting framework used to prepare the financial statements (including identifying the country of origin of the financial reporting framework when the framework used is not Sri Lanka Accounting Standards) and state the auditor’s opinion as to whether the financial statements give a true and fair view (or are presented fairly, in all material respects) in accordance with that financial reporting framework.

18. The terms used to express the auditor’s opinion are “give a true and fair view” or “present fairly, in all material respects” and are equivalent. Both terms
indicate, amongst other things, that the auditor considers only those matters that are material to the financial statements.

19. The financial reporting framework is determined by SLASs, rules issued by the Institute of Chartered Accountants of Sri Lanka, and the development of general practice within the country, with an appropriate consideration of fairness and with due regard to local legislation. To advise the reader of the context in which the auditor’s opinion is expressed, the auditor’s opinion indicates the framework upon which the financial statements are based. The auditor refers to the financial reporting framework in such terms as:

“… in accordance with Sri Lanka Accounting Standards (or [title of financial reporting framework with reference to the country of origin]) ….”

This designation will help the user to better understand which financial reporting framework was used in preparing the financial statements. When reporting on financial statements that are prepared specifically for use in another country, the auditor considers whether appropriate disclosure has been made in the financial statements about the financial reporting framework that has been used.

20. An illustration of these matters in an opinion paragraph is:

“In our opinion, so far as appears from our examination, the Company maintained proper accounting records for the year ended March 31, 20X9 and the financial statements give a true and fair view of the Company’s state of affairs as at March 31, 20X9 and its profit and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

(In our opinion, the consolidated financial statements give a true and fair view of the state of affairs as at March 31, 20X9 and the profit and cash flows for the year then ended, in accordance with Sri Lanka Accounting Standards, of the Company and its subsidiaries dealt with thereby, so far as concerns the shareholders of the Company⁴.)”

Report on Other Legal and Regulatory Requirements

21. When the auditor addresses other reporting responsibilities within the auditor’s report on the financial statements, these other reporting responsibilities should be addressed in a separate section in the auditor’s report that follows the opinion paragraph.

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⁴ This should be included, if applicable only.
22. The auditor addresses these other reporting responsibilities in a separate section of the report in order to clearly distinguish them from the auditor’s responsibilities for, and opinion on, the financial statements.

Date of Report

23. The auditor should date the report as of the completion date of the audit. This informs the reader that the auditor has considered the effect on the financial statements and on the report of events and transactions of which the auditor became aware and that occurred up to that date.

24. Since the auditor’s responsibility is to report on the financial statements as prepared and presented by management, the auditor should not date the report earlier than the date on which the financial statements are signed or approved by management.

Auditor’s Address

25. The report should name a specific location, which is ordinarily the city where the auditor maintains the office that has responsibility for the audit.

Auditor’s Signature

26. The report should be signed in the name of the audit firm, the personal name of the auditor or both, as appropriate. The auditor’s report is ordinarily signed in the name of the firm because the firm assumes responsibility for the audit.

The Auditor’s Report

27. An unqualified opinion should be expressed when the auditor concludes that the financial statements give a true and fair view (or are presented fairly, in all material respects) in accordance with the identified financial reporting framework. An unqualified opinion also indicates implicitly that any changes in accounting principles or in the method of their application, and the effects thereof, have been properly determined and disclosed in the financial statements.

28. The following is an illustration of the entire auditor’s report incorporating the basic elements set forth and illustrated above. This report illustrates the expression of an unqualified opinion.
“INDEPENDENT AUDITOR’S REPORT

TO THE SHAREHOLDERS OF ABC COMPANY
(OR APPROPRIATE ADDRESSEE)

Report on the Financial Statements

We have audited the accompanying financial statements of ABC Company, (the consolidated financial statements of the Company and its subsidiaries as at that date) which comprise the balance sheet as at March 31, 20X9, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management’s Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Accounting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Scope of Audit and Basis of Opinion

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Sri Lanka Auditing Standards. Those standards require that we plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting policies used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

We have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our audit. We therefore believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, so far as appears from our examination, the Company maintained proper accounting records for the year ended March 31, 20X9 and the financial

5 The reference can be by page numbers.

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statements give a true and fair view of the Company’s state of affairs as at March 31, 20X9 and its profit and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

(In our opinion, the consolidated financial statements give a true and fair view of the state of affairs as at March 31, 20X9 and the profit and cash flows for the year then ended, in accordance with Sri Lanka Accounting Standards, of the Company and its subsidiaries dealt with thereby, so far as concerns the shareholders of the Company.)*

Report on Other Legal and Regulatory Requirements

These financial statements also comply with the requirements of Section 151(2) {OR Sections 153(2) to 153(7) as appropriate}7 of the Companies Act No. 07 of 2007.8

[Form and content of this section of the auditor’s report will vary depending on the nature of the auditor’s other reporting responsibilities.]*

[Auditor’s signature]

>Date of the auditor’s report

[Auditor’s address]*

Modified Reports

29. An auditor’s report is considered to be modified in the following situations:

Matters that Do Not Affect the Auditor’s Opinion
(a) Emphasis of matter

Matters that Do Affect the Auditor’s Opinion
(a) Qualified opinion,
(b) Disclaimer of opinion, or
(c) Adverse opinion.

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6 This should be included, if applicable only.
7 This should be included, if applicable only, and the sub sections appropriately amended based on applicability to the group companies
8 This should be included in the case of the Companies governed under the Companies Act. No. 07 of 2007.
9 This should be included, if applicable only.

E.g. 1) Pursuant to Regulation of Insurance Industry Act, No. 43 of 2000 proper accounting records have been maintained as required by the related rules.
   2) These financial statements present the information required by the Banking Act, No. 30 of 1988.
Uniformity in the form and content of each type of modified report will further the user’s understanding of such reports. Accordingly, this SLAuS includes suggested wording to express an unqualified opinion as well as examples of modifying phrases for use when issuing modified reports.

**Matters that Do Not Affect the Auditor’s Opinion**

30. In certain circumstances, an auditor’s report may be modified by adding an emphasis of matter paragraph to highlight a matter affecting the financial statements which is included in a note to the financial statements that more extensively discusses the matter. The addition of such an emphasis of matter paragraph does not affect the auditor’s opinion. The paragraph would preferably be included after the opinion paragraph and would ordinarily refer to the fact that the auditor’s opinion is not qualified in this respect.

31. The auditor should modify the auditor’s report by adding a paragraph to highlight a material matter regarding a going concern problem.

32. The auditor should consider modifying the auditor’s report by adding a paragraph if there is a significant uncertainty (other than a going concern problem), the resolution of which is dependent upon future events and which may affect the financial statements. An uncertainty is a matter whose outcome depends on future actions or events not under the direct control of the entity but that may affect the financial statements.

33. An illustration of an emphasis of matter paragraph for a significant uncertainty in an auditor’s report follows:

   “In our opinion ... (remaining words are the same as illustrated in the opinion paragraph – paragraph 28 above).

   Without qualifying our opinion we draw attention to Note X to the financial statements. The Company is the defendant in a lawsuit alleging infringement of certain patent rights and claiming royalties and punitive damages. The Company has filed a counter action, and preliminary hearings and discovery proceedings on both actions are in progress. The ultimate outcome of the matter cannot presently be determined, and no provision for any liability that may result has been made in the financial statements.”

(An illustration of an emphasis of matter paragraph relating to going concern is set out in SLAuS 570, “Going Concern.”)

34. The addition of a paragraph emphasizing a going concern problem or significant uncertainty is ordinarily adequate to meet the auditor’s reporting responsibilities regarding such matters. However, in extreme cases, such as situations involving multiple uncertainties that are significant to the financial
statements, the auditor may consider it appropriate to express a disclaimer of opinion instead of adding an emphasis of matter paragraph.

35. In addition to the use of an emphasis of matter paragraph for matters that affect the financial statements, the auditor may also modify the auditor’s report by using an emphasis of matter paragraph, preferably after the opinion paragraph, to report on matters other than those affecting the financial statements. For example, if an amendment to other information in a document containing audited financial statements is necessary and the entity refuses to make the amendment, the auditor would consider including in the auditor’s report an emphasis of matter paragraph describing the material inconsistency.

Matters that Do Affect the Auditor’s Opinion

36. An auditor may not be able to express an unqualified opinion when either of the following circumstances exist and, in the auditor’s judgment, the effect of the matter is or may be material to the financial statements:

(a) There is a limitation on the scope of the auditor’s work; or

(b) There is a disagreement with management regarding the acceptability of the accounting policies selected, the method of their application or the adequacy of financial statement disclosures.

The circumstances described in (a) could lead to a qualified opinion or a disclaimer of opinion. The circumstances described in (b) could lead to a qualified opinion or an adverse opinion. These circumstances are discussed more fully in paragraphs 41-46.

37. A qualified opinion should be expressed when the auditor concludes that an unqualified opinion cannot be expressed but that the effect of any disagreement with management, or limitation on scope is not so material and pervasive as to require an adverse opinion or a disclaimer of opinion. A qualified opinion should be expressed as being ‘except for’ the effects of the matter to which the qualification relates.

38. A disclaimer of opinion should be expressed when the possible effect of a limitation on scope is so material and pervasive that the auditor has not been able to obtain sufficient appropriate audit evidence and accordingly is unable to express an opinion on the financial statements.

39. An adverse opinion should be expressed when the effect of a disagreement is so material and pervasive to the financial statements that the auditor concludes that a qualification of the report is not adequate to disclose the misleading or incomplete nature of the financial statements.

40. Whenever the auditor expresses an opinion that is other than unqualified, a clear description of all the substantive reasons should be included in the
report and, unless impracticable, a quantification of the possible effect(s) on the financial statements. Ordinarily, this information would be set out in a separate paragraph preceding the opinion or disclaimer of opinion and may include a reference to a more extensive discussion, if any, in a note to the financial statements.

Circumstances that may Result in Other than an Unqualified Opinion

Limitation on Scope

41. A limitation on the scope of the auditor’s work may sometimes be imposed by the entity (for example, when the terms of the engagement specify that the auditor will not carry out an audit procedure that the auditor believes is necessary). However, when the limitation in the terms of a proposed engagement is such that the auditor believes the need to express a disclaimer of opinion exists, the auditor would ordinarily not accept such a limited engagement as an audit engagement, unless required by statute. Also, a statutory auditor would not accept such an audit engagement when the limitation infringes on the auditor’s statutory duties.

42. A scope limitation may be imposed by circumstances (for example, when the timing of the auditor’s appointment is such that the auditor is unable to observe the counting of physical inventories). It may also arise when, in the opinion of the auditor, the entity’s accounting records are inadequate or when the auditor is unable to carry out an audit procedure believed to be desirable. In these circumstances, the auditor would attempt to carry out reasonable alternative procedures to obtain sufficient appropriate audit evidence to support an unqualified opinion.

43. When there is a limitation on the scope of the auditor’s work that requires expression of a qualified opinion or a disclaimer of opinion, the auditor’s report should describe the limitation and indicate the possible adjustments to the financial statements that might have been determined to be necessary had the limitation not existed.

44. Illustrations of these matters are set out below.

Limitation on Scope—Qualified Opinion

“We have audited ... (remaining words are the same as illustrated in the introductory paragraph – paragraph 28 above).

Management is responsible … (remaining words are the same as illustrated in the paragraph 28 above).
Our responsibility is to express an opinion on these financial statements based on our audit. Except as discussed in the following paragraph, we conducted our audit in accordance with ... (remaining words are the same as illustrated in the Scope of Audit and Basis of Opinion paragraph 28 above including the second paragraph).

Except as discussed in a following paragraph, we have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our audit. We therefore believe that our audit provides a reasonable basis for our qualified opinion.

We did not observe the counting of the physical inventories as of March 31, 20X9, since that date was prior to the time we were initially engaged as auditors for the Company. Owing to the nature of the Company’s records, we were unable to satisfy ourselves as to inventory quantities by other audit procedures.

In our opinion, so far as appears from our examination, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to satisfy ourselves as to physical inventory quantities, the Company maintained proper accounting records for the year ended March 31, 20X9 and the financial statements give a true and ... (remaining words are the same as illustrated in the opinion paragraph – paragraph 28 above).”

Limitation on Scope—Disclaimer of Opinion

“We were engaged to audit the accompanying financial statements of ABC Company, which comprise the balance sheet as at March 31, 20X9, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management is responsible...(remaining words are the same as illustrated in the paragraph 28 above)

(Omit the sentence stating the responsibility of the auditor).

(The paragraphs discussing the scope of the audit and basis of opinion would either be omitted or amended according to the circumstances.)

We have not obtained adequate information and explanations as discussed in the following paragraph, for the purposes of our audit.

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10 The reference can be by page numbers.
We therefore believe that our audit provides a reasonable basis for our disclaimer of opinion.

(Add a paragraph discussing the scope limitation as follows:)

We were not able to observe all physical inventories and confirm accounts receivable due to limitations placed on the scope of our work by the Company.

Because of the significance of the matters discussed in the preceding paragraph, we do not express an opinion on the financial statements of the company.”

Disagreement with Management

45. The auditor may disagree with management about matters such as the acceptability of accounting policies selected, the method of their application, or the adequacy of disclosures in the financial statements. If such disagreements are material to the financial statements, the auditor should express a qualified or an adverse opinion.

46. Illustrations of these matters are set out below.

Disagreement on Accounting Policies—Inappropriate Accounting Method—Qualified Opinion

“We have audited ... (remaining words are the same as illustrated in the introductory paragraph – paragraph 28 above).

Management is responsible ... (remaining words are the same as illustrated in the paragraph 28 above).

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with ... (remaining words are the same as illustrated in the Scope of Audit and Basis of Opinion paragraph 28 above including the second and third paragraphs).

As discussed in Note X to the financial statements, no depreciation has been provided in the financial statements which practice, in our opinion, is not in accordance with Sri Lanka Accounting Standards. The provision for the year ended March 31, 20X9, should be xxx based on the straight-line method of depreciation using annual rates of 5% for the building and 20% for the equipment. Accordingly, the fixed assets should be reduced by accumulated depreciation of xxx and the loss for the year and accumulated deficit should be increased by xxx and xxx, respectively.
In our opinion, so far as appears from our examination, except for the effect on the financial statements of the matter referred to in the preceding paragraph, the Company maintained proper accounting records for the year ended March 31, 20X9 and the financial statements give a true and ... (remaining words are the same as illustrated in the opinion paragraph – paragraph 28 above).”

**Disagreement on Accounting Policies—Inadequate Disclosure— Qualified Opinion**

“We have audited ... (remaining words are the same as illustrated in the introductory paragraph – paragraph 28 above).

Management is responsible ... (remaining words are the same as illustrated in the paragraph 28 above).

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with ... (remaining words are the same as illustrated in the Scope of Audit and Basis of Opinion paragraph 28 above including the second and third paragraphs).

On January 15, 20X9, the Company issued debentures in the amount of xxx for the purpose of financing plant expansion. The debenture agreement restricts the payment of future cash dividends to earnings after March 31, 20X3. In our opinion, disclosure of this information is required by ... 11

In our opinion, so far as appears from our examination, except for the omission of the information included in the preceding paragraph, the Company maintained proper accounting records for the year ended March 31, 20X9 and the financial statements give a true and ... (remaining words are the same as illustrated in the opinion paragraph – paragraph 28 above).”

**Disagreement on Accounting Policies—Inadequate Disclosure— Adverse Opinion**

“We have audited ... (remaining words are the same as illustrated in the introductory paragraph – paragraph 28 above).

Management is responsible for the preparation and fair presentation ... (remaining words are the same as illustrated in the paragraph 28 above)

11 Refer to the relevant statute or law.
Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with ... (remaining words are the same as illustrated in the Scope of Audit and Basis of Opinion paragraph 28 above including the second and third paragraphs).

(Paragraph(s) discussing the disagreement).

In our opinion, so far as appears from our examination, because of the effects of the matters discussed in the preceding paragraph(s), the financial statements do not give a true and fair view of the Company’s state of affairs as at March 31, 20X9 and its profit and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.”

Compliance with International Standards on Auditing

47. Compliance with this SLAuS ensures compliance in all material respects with International Standard on Auditing 700.

Effective Date

48. This SLAuS is effective for all the audits carried out on or after ............

Public Sector Perspective

1. While the basic principles contained in this SLAuS apply to the audit of financial statements in the public sector, the statutes giving rise to the audit mandate may specify the nature, content and form of the auditor’s report.

2. This SLAuS does not address the form and content of the auditor’s report in circumstances where financial statements are prepared in conformity with a disclosed basis of accounting, whether mandated by statutes or any other regulations and that basis results in financial statements which are misleading.