

HKSA 200 (Revised)\*  
Issued October 2006

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Effective for audits of financial statements  
for periods beginning on or after 15 December 2005 and  
where auditor's reports are dated on or after 31 December 2006\*

*Hong Kong Standard on Auditing 200 (Revised)*

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# **Objective and General Principles Governing an Audit of Financial Statements**

\* HKSA 700, "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements" gave rise to conforming amendments to HKSA 200, "Objective and General Principles Governing an Audit of Financial Statements". The conforming amendments are reflected in this HKSA 200 (Revised) and are effective for audits of financial statements for periods beginning on or after 15 December 2005 and where auditor's reports are dated on or after 31 December 2006.



Hong Kong Institute of  
**Certified Public Accountants**  
香港會計師公會

**HONG KONG STANDARD ON AUDITING 200 (REVISED)**  
**OBJECTIVE AND GENERAL PRINCIPLES GOVERNING**  
**AN AUDIT OF FINANCIAL STATEMENTS**

(Effective for audits of financial statements for periods  
beginning on or after 15 December 2005 and  
where auditor's reports are dated on or after 31 December 2006)\*

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Hong Kong Standard on Auditing (HKSA) 200 (Revised), "Objective and General Principles Governing an Audit of Financial Statements" should be read in the context of the "Preface to Hong Kong Standards on Quality Control, Auditing, Assurance and Related Services" which sets out the application and authority of HKSAs.

\* HKSA 315, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement", HKSA 330, "The Auditor's Procedures in Response to Assessed Risks" and HKSA 500, "Audit Evidence" gave rise to conforming amendments to HKSA 200. These amendments are effective for audits of financial statements for periods beginning on or after 15 December 2004 and have been incorporated in the text of HKSA 200.

HKSA 700, "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements" gave rise to conforming amendments to HKSA 200. The conforming amendments are effective for audits of financial statements for periods beginning on or after 15 December 2005 where auditor's reports are dated on or after 31 December 2006 and have been incorporated in the text of this HKSA 200 (Revised). As implementation of the final sentence of paragraph 3 and paragraphs 37 to 48 of ISA 200 has been deferred, they have not been reflected in the body of this HKSA 200 (Revised). They are included in the Appendix to this HKSA 200 (Revised).

HKSA 230 (Revised), "Audit Documentation" gave rise to conforming amendments to HKSA 200 (Revised). These amendments are effective for audits of financial statements for periods beginning on or after 15 June 2006 and have been incorporated in the text of this HKSA 200 (Revised) (see footnote 1a).

## Introduction

1. The purpose of this Hong Kong Standard on Auditing (HKSA) is to establish standards and provide guidance on the objective and general principles governing an audit of financial statements. It also describes management's responsibility for the preparation and presentation of the financial statements and for identifying the financial reporting framework to be used in preparing the financial statements, referred to in the HKSAs as the "applicable financial reporting framework."

## Objective of an Audit of Financial Statements

2. **The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.**
3. An audit of financial statements is an assurance engagement, as defined in the Hong Kong Framework for Assurance Engagements. The Framework defines and describes the elements and objectives of an assurance engagement. The HKSAs apply the Framework in the context of an audit of financial statements and contain the basic principles and essential procedures, together with related guidance, to be applied in such an audit. Paragraphs 34-35 in this HKSA discuss the meaning of the term "financial statements" and management's responsibility for such statements. As discussed in the Framework, a condition for acceptance of an assurance engagement is that the criteria referred to in the definition are "suitable criteria" and available to intended users.<sup>1</sup>

## Ethical Requirements Relating to an Audit of Financial Statements

4. **The auditor should comply with relevant ethical requirements relating to audit engagements.**
5. As discussed in HKSA 220, "Quality Control for Audits of Historical Financial Information," ethical requirements relating to audits of financial statements ordinarily comprise HKICPA's *Code of Ethics for Professional Accountants* (the Code). HKSA 220 identifies the fundamental principles of professional ethics established by the Code and sets out the engagement partner's responsibilities with respect to ethical requirements. HKSA 220 recognizes that the engagement team is entitled to rely on a firm's systems in meeting its responsibilities with respect to quality control procedures applicable to the individual audit engagement (for example, in relation to capabilities and competence of personnel through their recruitment and formal training; independence through the accumulation and communication of relevant independence information; maintenance of client relationships through acceptance and continuance systems; and adherence to regulatory and legal requirements through the monitoring process), unless information provided by the firm or other parties suggests otherwise. Accordingly, Hong Kong Standard on Quality Control (HKSQC) 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements," requires the firm to establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements.

## Conduct of an Audit of Financial Statements

6. **The auditor should conduct an audit in accordance with Hong Kong Standards on Auditing.**
7. HKSAs contain basic principles and essential procedures together with related guidance in the form of explanatory and other material, including appendices. The basic principles and essential procedures are to be understood and applied in the context of explanatory and other material that provide guidance for their application. The text of a whole Standard is considered in order to understand and apply the basic principles and essential procedures.

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<sup>1</sup> See Appendix to this HKSA in relation to paragraphs 37 to 48 of ISA 200 which discuss suitable criteria and their availability to intended users for an audit of financial statements through the auditor's consideration of the acceptability of the financial reporting framework. These paragraphs have been deferred by the IAASB (effective date yet to be determined).

8. In conducting an audit in accordance with HKSAs, the auditor is also aware of and considers Practice Notes and Auditing Guidelines (PNs and AGs) applicable to the audit engagement. PNs and AGs provide interpretive guidance and practical assistance to auditors in implementing HKSAs. An auditor who does not apply the guidance included in a relevant PN and AG needs to be prepared to explain how the basic principles and essential procedures in the Standard addressed by the PN and AG have been complied with.
9. The auditor may also conduct the audit in accordance with both HKSAs and auditing standards of a specific jurisdiction or country.

### Scope of an Audit of Financial Statements

10. The term “scope of an audit” refers to the audit procedures that, in the auditor’s judgment and based on the HKSAs, are deemed appropriate in the circumstances to achieve the objective of the audit.
11. **In determining the audit procedures to be performed in conducting an audit in accordance with Hong Kong Standards on Auditing, the auditor should comply with each of the Hong Kong Standards on Auditing relevant to the audit.**
12. In performing an audit, auditors may be required to comply with other professional, legal or regulatory requirements in addition to the HKSAs. The HKSAs do not override the local laws and regulations that govern an audit of financial statements. In the event that those laws and regulations differ from the HKSAs, an audit conducted in accordance with the local laws and regulations will not automatically comply with HKSAs.
13. When the auditor conducts the audit in accordance with HKSAs and auditing standards of a specific jurisdiction or country, in addition to complying with each of the HKSAs relevant to the audit, the auditor also performs any additional audit procedures necessary to comply with the relevant standards of that jurisdiction or country.
14. **The auditor should not represent compliance with Hong Kong Standards on Auditing unless the auditor has complied fully with all of the Hong Kong Standards on Auditing relevant to the audit.**
- 14A. The auditor may, in exceptional circumstances, judge it necessary to depart from a basic principle or an essential procedure that is relevant in the circumstances of the audit, in order to achieve the objective of the audit. In such a case, the auditor is not precluded from representing compliance with HKSAs, provided the departure is appropriately documented as required by HKSA 230, “Audit Documentation”.<sup>1a</sup>

### Professional Skepticism

15. **The auditor should plan and perform an audit with an attitude of professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated.**
16. An attitude of professional skepticism means the auditor makes a critical assessment, with a questioning mind, of the validity of audit evidence obtained and is alert to audit evidence that contradicts or brings into question the reliability of documents and responses to inquiries and other information obtained from management and those charged with governance. For example, an attitude of professional skepticism is necessary throughout the audit process for the auditor to reduce the risk of overlooking unusual circumstances, of over generalizing when drawing conclusions from audit observations, and of using faulty assumptions in determining the nature, timing and extent of the audit procedures and evaluating the results thereof. When making inquiries and performing other audit procedures, the auditor is not satisfied with less-than-persuasive audit evidence based on a belief that management and those charged with governance are honest and have integrity. Accordingly, representations from management are not a substitute for obtaining sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor’s opinion.

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<sup>1a</sup> These are conforming amendments arising from HKSA 230, “Audit Documentation” which are effective for audits of financial statements for periods beginning on or after 15 June 2006.

## Reasonable Assurance

17. An auditor conducting an audit in accordance with HKSAs obtains reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a concept relating to the accumulation of the audit evidence necessary for the auditor to conclude that there are no material misstatements in the financial statements taken as a whole. Reasonable assurance relates to the whole audit process.
18. An auditor cannot obtain absolute assurance because there are inherent limitations in an audit that affect the auditor's ability to detect material misstatements. These limitations result from factors such as the following:
  - The use of testing.
  - The inherent limitations of internal control (for example, the possibility of management override or collusion).
  - The fact that most audit evidence is persuasive rather than conclusive.
19. Also, the work undertaken by the auditor to form an audit opinion is permeated by judgment, in particular regarding:
  - (a) The gathering of audit evidence, for example, in deciding the nature, timing and extent of audit procedures; and
  - (b) The drawing of conclusions based on the audit evidence gathered, for example, assessing the reasonableness of the estimates made by management in preparing the financial statements.
20. Further, other limitations may affect the persuasiveness of audit evidence available to draw conclusions on particular assertions<sup>2</sup> (for example, transactions between related parties). In these cases certain HKSAs identify specified audit procedures which will, because of the nature of the particular assertions, provide sufficient appropriate audit evidence in the absence of:
  - (a) Unusual circumstances which increase the risk of material misstatement beyond that which would ordinarily be expected; or
  - (b) Any indication that a material misstatement has occurred.
21. Accordingly, because of the factors described above, an audit is not a guarantee that the financial statements are free from material misstatement, because absolute assurance is not attainable. Further, an audit opinion does not assure the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity.

## Audit Risk and Materiality

22. Entities pursue strategies to achieve their objectives, and depending on the nature of their operations and industry, the regulatory environment in which they operate, and their size and complexity, they face a variety of business risks.<sup>3</sup> Management is responsible for identifying such risks and responding to them. However, not all risks relate to the preparation of the financial statements. The auditor is ultimately concerned only with risks that may affect the financial statements.
23. The auditor obtains and evaluates audit evidence to obtain reasonable assurance about whether the financial statements give a true and fair view or are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. The concept of reasonable assurance acknowledges that there is a risk the audit opinion is inappropriate. The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated is known as "audit risk."<sup>4</sup>

<sup>2</sup> Paragraphs 15-18 of HKSA 500, "Audit Evidence," discuss the use of assertions in obtaining audit evidence.

<sup>3</sup> Paragraphs 30-34 of HKSA 315, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement," discuss the concept of business risks and how they relate to risks of material misstatement.

<sup>4</sup> This definition of audit risk does not include the risk that the auditor might erroneously express an opinion that the financial statements are materially misstated.

24. **The auditor should plan and perform the audit to reduce audit risk to an acceptably low level that is consistent with the objective of an audit.** The auditor reduces audit risk by designing and performing audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base an audit opinion. Reasonable assurance is obtained when the auditor has reduced audit risk to an acceptably low level.
25. Audit risk is a function of the risk of material misstatement of the financial statements (or simply, the “risk of material misstatement”) (i.e., the risk that the financial statements are materially misstated prior to audit) and the risk that the auditor will not detect such misstatement (“detection risk”). The auditor performs audit procedures to assess the risk of material misstatement and seeks to limit detection risk by performing further audit procedures based on that assessment (see HKSA 315, “Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement” and HKSA 330, “The Auditor’s Procedures in Response to Assessed Risks”). The audit process involves the exercise of professional judgment in designing the audit approach, through focusing on what can go wrong (i.e., what are the potential misstatements that may arise) at the assertion level (see HKSA 500, “Audit Evidence”) and performing audit procedures in response to the assessed risks in order to obtain sufficient appropriate audit evidence.
26. The auditor is concerned with material misstatements, and is not responsible for the detection of misstatements that are not material to the financial statements taken as a whole. The auditor considers whether the effect of identified uncorrected misstatements, both individually and in the aggregate, is material to the financial statements taken as a whole. Materiality and audit risk are related (see HKSA 320, “Audit Materiality”). In order to design audit procedures to determine whether there are misstatements that are material to the financial statements taken as a whole, the auditor considers the risk of material misstatement at two levels: the overall financial statement level and in relation to classes of transactions, account balances, and disclosures and the related assertions.<sup>5</sup>
27. The auditor considers the risk of material misstatement at the overall financial statement level, which refers to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions. Risks of this nature often relate to the entity’s control environment (although these risks may also relate to other factors, such as declining economic conditions), and are not necessarily risks identifiable with specific assertions at the class of transactions, account balance, or disclosure level. Rather, this overall risk represents circumstances that increase the risk that there could be material misstatements in any number of different assertions, for example, through management override of internal control. Such risks may be especially relevant to the auditor’s consideration of the risk of material misstatement arising from fraud. The auditor’s response to the assessed risk of material misstatement at the overall financial statement level includes consideration of the knowledge, skill, and ability of personnel assigned significant engagement responsibilities, including whether to involve experts; the appropriate levels of supervision; and whether there are events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern.

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<sup>5</sup> HKSA 315, “Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement” provides additional guidance on the auditor’s requirement to assess risks of material misstatement at the financial statement level and at the assertion level.

28. The auditor also considers the risk of material misstatement at the class of transactions, account balance, and disclosure level because such consideration directly assists in determining the nature, timing, and extent of further audit procedures at the assertion level.<sup>6</sup> The auditor seeks to obtain sufficient appropriate audit evidence at the class of transactions, account balance, and disclosure level in such a way that enables the auditor, at the completion of the audit, to express an opinion on the financial statements taken as a whole at an acceptably low level of audit risk. Auditors use various approaches to accomplish that objective.<sup>7</sup>
29. The discussion in the following paragraphs provides an explanation of the components of audit risk. The risk of material misstatement at the assertion level consists of two components as follows:
- “Inherent risk” is the susceptibility of an assertion to a misstatement that could be material, either individually or when aggregated with other misstatements, assuming that there are no related controls. The risk of such misstatement is greater for some assertions and related classes of transactions, account balances, and disclosures than for others. For example, complex calculations are more likely to be misstated than simple calculations. Accounts consisting of amounts derived from accounting estimates that are subject to significant measurement uncertainty pose greater risks than do accounts consisting of relatively routine, factual data. External circumstances giving rise to business risks may also influence inherent risk. For example, technological developments might make a particular product obsolete, thereby causing inventory to be more susceptible to overstatement. In addition to those circumstances that are peculiar to a specific assertion, factors in the entity and its environment that relate to several or all of the classes of transactions, account balances, or disclosures may influence the inherent risk related to a specific assertion. These latter factors include, for example, a lack of sufficient working capital to continue operations or a declining industry characterized by a large number of business failures.
  - “Control risk” is the risk that a misstatement that could occur in an assertion and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity’s internal control. That risk is a function of the effectiveness of the design and operation of internal control in achieving the entity’s objectives relevant to preparation of the entity’s financial statements. Some control risk will always exist because of the inherent limitations of internal control.
30. Inherent risk and control risk are the entity’s risks; they exist independently of the audit of the financial statements. The auditor is required to assess the risk of material misstatement at the assertion level as a basis for further audit procedures, though that assessment is a judgment, rather than a precise measurement of risk. When the auditor’s assessment of the risk of material misstatement includes an expectation of the operating effectiveness of controls, the auditor performs tests of controls to support the risk assessment. The HKSAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the “risk of material misstatement.” Although the HKSAs ordinarily describe a combined assessment of the risk of material misstatement, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risk of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.
31. “Detection risk” is the risk that the auditor will not detect a misstatement that exists in an assertion that could be material, either individually or when aggregated with other

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<sup>6</sup> HKSA 330, “The Auditor’s Procedures in Response to Assessed Risks” provides additional guidance on the requirement for the auditor to design and perform further audit procedures in response to the assessed risks at the assertion level.

<sup>7</sup> The auditor may make use of a model that expresses the general relationship of the components of audit risk in mathematical terms to arrive at an appropriate level of detection risk. Some auditors find such a model to be useful when planning audit procedures to achieve a desired audit risk though the use of such a model does not eliminate the judgment inherent in the audit process.

misstatements. Detection risk is a function of the effectiveness of an audit procedure and of its application by the auditor. Detection risk cannot be reduced to zero because the auditor usually does not examine all of a class of transactions, account balance, or disclosure and because of other factors. Such other factors include the possibility that an auditor might select an inappropriate audit procedure, misapply an appropriate audit procedure, or misinterpret the audit results. These other factors ordinarily can be addressed through adequate planning, proper assignment of personnel to the engagement team, the application of professional skepticism, and supervision and review of the audit work performed.

32. Detection risk relates to the nature, timing, and extent of the auditor's procedures that are determined by the auditor to reduce audit risk to an acceptably low level. For a given level of audit risk, the acceptable level of detection risk bears an inverse relationship to the assessment of the risk of material misstatement at the assertion level. The greater the risk of material misstatement the auditor believes exists, the less the detection risk that can be accepted. Conversely, the less risk of material misstatement the auditor believes exist, the greater the detection risk that can be accepted.

### Responsibility for the Financial Statements

33. While the auditor is responsible for forming and expressing an opinion on the financial statements, the responsibility for the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework is that of the management<sup>8</sup> of the entity, with oversight from those charged with governance.<sup>9</sup> The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.
34. The term "financial statements" refers to a structured representation of the financial information, which ordinarily includes accompanying notes, derived from accounting records and intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The term can refer to a complete set of financial statements, but it can also refer to a single financial statement, for example, a balance sheet, or a statement of revenues and expenses, and related explanatory notes.
35. The requirements of the financial reporting framework determine the form and content of the financial statements and what constitutes a complete set of financial statements. For certain financial reporting frameworks, a single financial statement such as a cash flow statement and the related explanatory notes constitutes a complete set of financial statements. For example, the International Public Sector Accounting Standard (IPSAS), "Financial Reporting Under the Cash Basis of Accounting," states that the primary financial statement is a statement of cash receipts and payments when a public sector entity prepares and presents its financial statements in accordance with that IPSAS. Financial statements prepared by reference to Hong Kong Financial Reporting Standards (HKFRSs) or International Financial Reporting Standards (IFRSs), on the other hand, are intended to provide information about the financial position, performance and cash flows of an entity. A complete set of financial statements under HKFRSs or IFRSs includes a balance sheet; an income statement; a statement of changes in equity; a cash flow statement; and notes, comprising a summary of significant accounting policies and other explanatory notes.
36. Management is responsible for identifying the financial reporting framework to be used in the preparation and presentation of the financial statements. Management is also responsible for preparing and presenting the financial statements in accordance with that applicable financial reporting framework. This responsibility includes:
- Designing, implementing and maintaining internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error;

<sup>8</sup> The term "management" has been used in this HKSA to describe those responsible for the preparation and presentation of the financial statements. Other terms may be appropriate depending on the legal framework in the particular jurisdiction.

<sup>9</sup> The structures of governance vary from country to country, reflecting cultural and legal backgrounds. Therefore, the respective responsibilities of management and those charged with governance vary depending on the legal responsibilities in the particular jurisdiction.



- Selecting and applying appropriate accounting policies; and
- Making accounting estimates that are reasonable in the circumstances.

### **Determining the Acceptability of the Financial Reporting Framework<sup>10</sup>**

37. – 48. [See paragraph 1 of Appendix]

### **Expressing an Opinion on the Financial Statements**

49. When the auditor is expressing an opinion on a complete set of general purpose financial statements prepared in accordance with a financial reporting framework that is designed to achieve fair presentation, the auditor refers to HKSA 700, “The Independent Auditor’s Report on a Complete Set of General Purpose Financial Statements,” for standards and guidance on the matters the auditor considers in forming an opinion on such financial statements and on the form and content of the auditor’s report. The auditor also refers to HKSA 701 when expressing a modified audit opinion, including an emphasis of matter, a qualified opinion, a disclaimer of opinion or an adverse opinion.

50. and 51. [See paragraph 2 of Appendix]

### **Effective Date**

52. This HKSA is effective for audits of financial statements for periods beginning on or after 15 December 2005 and where auditor’s reports are dated on or after 31 December 2006.

### **Conformity and Compliance with International Standards on Auditing**

53. As of October 2006 (date of issue), this HKSA conforms with the version of International Standard on Auditing (ISA) 200, “Objective and General Principles Governing An Audit of Financial Statements” that is effective for audits of financial statements for period beginning on or after 15 December 2005. Compliance with the requirements of this HKSA ensures compliance with ISA 200.

54. Additional local explanations are provided in footnotes 1, 1a, 10 and the Appendix.

### **Public Sector Perspective**

1. *Irrespective of whether an audit is being conducted in the private or public sector, the basic principles of auditing remain the same. What may differ for audits carried out in the public sector is the audit objective and scope. These factors are often attributable to differences in the audit mandate and legal requirements or the form of reporting (for example, public sector entities may be required to prepared additional financial reports).*
2. *When carrying out audits of public sector entities, the auditor will need to take into account the specific requirements of any other relevant regulations, ordinances or ministerial directives which affect the audit mandate and any special auditing requirements, including the need to have regard to issues of national security. Audit mandates may be more specific than those in the private sector, and often encompass a wider ranged of objectives and a broader scope than is ordinarily applicable for the audit of private sector financial statements. The mandates and requirements may also effect, for example, the extent of the auditor’s discretion in establishing materiality, in reporting fraud and error, and in the form of the auditor’s report. Differences in audit approach and style may also exist. However, these differences would not constitute a difference in the basic principles and essential procedures.*

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<sup>10</sup> As the implementation of paragraphs 37 to 48 has been deferred by the IAASB, these paragraphs have not been reflected in the body of this HKSA 200 (Revised). These paragraphs are included in the Appendix to this HKSA 200 (Revised).

## Appendix

### Deferred Paragraphs

1. The application of the final sentence of paragraph 3 and paragraphs 37 to 48 of ISA 200, “Objective and General Principles Governing an Audit of Financial Statements” have been deferred by the IAASB (effective date yet to be determined) pending the revision of ISA 800, “The Independent Auditor’s Report on Special Purpose Audit Engagements”. The sentence and paragraphs are shown below for reference and will be incorporated in this Standard when effective.
  3. *Paragraphs 37 to 48 in this ISA discuss suitable criteria and their availability to intended users for an audit of financial statements through the auditor’s consideration of the acceptability of the financial reporting framework*

#### **Determining the Acceptability of the Financial Reporting Framework**

37. ***The auditor should determine whether the financial reporting framework adopted by management in preparing the financial statements is acceptable. The auditor ordinarily makes this determination when considering whether to accept the audit engagement, as discussed in ISA 210, “Terms of Audit Engagements.” An acceptable financial reporting framework is referred to in the ISAs as the “applicable financial reporting framework.”***
38. *The auditor determines whether the financial reporting framework adopted by management is acceptable in view of the nature of the entity (for example, whether it is a business enterprise, a public sector entity or a not for profit organization) and the objective of the financial statements.*

#### **Financial Statements Designed to Meet the Financial Information Needs of Specific Users**

39. *In some cases, the objective of the financial statements will be to meet the financial information needs of specific users. The information needs of such users will determine the applicable financial reporting framework in these circumstances. Examples of financial reporting frameworks that address the needs of specific users are: a tax basis of accounting for a set of financial statements that accompany an entity’s tax return; the financial reporting provisions of a government regulatory agency for a set of financial statements to meet the information needs of that agency; or a financial reporting framework established by the provisions of an agreement specifying the financial statements to be prepared. Financial statements prepared in accordance with such financial reporting frameworks may be the only financial statements prepared by an entity and, in such circumstances, are often used by users in addition to those for whom the financial reporting framework is designed. Despite the broad distribution of the financial statements in those circumstances, the financial statements are still considered to be designed to meet the financial information needs of specific users for purposes of the ISAs. ISA 800<sup>11</sup>, “The Independent Auditor’s Report on Special Purpose Audit Engagements” establishes standards and provides guidance on financial statements whose objective is to meet the financial information needs of specific users. Although specific users may not be identified, financial statements that are prepared in accordance with a framework that is not designed to achieve fair presentation are also addressed in ISA 800.*

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<sup>11</sup> ISA 800 is currently under revision by the IAASB and revised ISA 800 will be considered for adoption by the HKICPA. .

**Financial Statements Designed to Meet the Common Financial Information Needs of a Wide Range of Users**

40. *Many users of financial statements are not in a position to demand financial statements tailored to meet their specific information needs. While all the information needs of specific users cannot be met, there are financial information needs that are common to a wide range of users. Financial statements prepared in accordance with a financial reporting framework that is designed to meet the common information needs of a wide range of users are referred to as “general purpose financial statements.”*

**Financial Reporting Frameworks Established by Authorized or Recognized Organizations**

41. *At present, there is no objective and authoritative basis that has been generally recognized globally for judging the acceptability of financial reporting frameworks that have been designed for general purpose financial statements. Until such a basis exists, financial reporting frameworks established by organizations that are authorized or recognized to promulgate standards to be used by certain types of entities are presumed to be acceptable for general purpose financial statements prepared by such entities provided the organizations follow an established and transparent process involving deliberation and consideration of the views of a wide range of stakeholders. Examples of such financial reporting frameworks include:*

- *IFRSs promulgated by the International Accounting Standards Board;*
- *IPSASs promulgated by the International Federation of Accountants – International Public Sector Accounting Standards Board; and*
- *Generally accepted accounting principles promulgated by a recognized standards setter in a particular jurisdiction.*

*These financial reporting frameworks are often identified as the applicable financial reporting framework in legislative and regulatory requirements governing the preparation of general purpose financial statements. Refer to ISA 800 for financial reporting frameworks designed to meet the particular needs of a government regulatory agency.*

**Financial Reporting Frameworks Supplemented with Legislative and Regulatory Requirements**

42. *In some jurisdictions, legislative and regulatory requirements may supplement a financial reporting framework adopted by management with additional requirements relating to the preparation and presentation of financial statements. In these jurisdictions, the applicable financial reporting framework, for the purposes of applying the ISAs, encompasses both the identified financial reporting framework and such additional requirements, provided they do not conflict with the applicable financial reporting framework. This may, for example, be the case when additional requirements prescribe disclosures in addition to those required by the identified financial reporting framework or when they narrow the range of acceptable choices that can be made within the identified financial reporting framework. If the additional requirements conflict with the applicable financial reporting framework, the auditor discusses the nature of the requirements with management and whether the additional requirements can be met through additional disclosures. If this is not possible, the auditor considers whether it is necessary to modify the auditor’s report, see ISA 701, “Modifications to the Independent Auditor’s Report.”*

**Jurisdictions that Do Not have an Authorized or Recognized Standards Setting Organization**

43. *When an entity is registered or operating in a jurisdiction that does not have an authorized or recognized standards setting organization, the entity identifies an*

*applicable financial reporting framework. Practice in such jurisdictions is often to use a financial reporting framework established by one of the organizations described in paragraph 41. Alternatively, there may be established accounting conventions in a particular jurisdiction that are generally recognized as the applicable financial reporting framework for the general purpose financial statements prepared by certain specified entities operating in that jurisdiction. When such a financial reporting framework is adopted by the entity, the auditor determines whether the accounting conventions collectively can be considered to constitute an acceptable financial reporting framework for general purpose financial statements. When the accounting conventions are widely used in a particular jurisdiction, the accounting profession in that jurisdiction may have considered the acceptability of the financial reporting framework on behalf of the auditors. Alternatively, the auditor makes this determination by considering whether the accounting conventions exhibit attributes normally exhibited by acceptable financial reporting frameworks or by comparing the accounting conventions to the requirements of an existing financial reporting framework considered to be acceptable.*

44. *Acceptable financial reporting frameworks for general purpose financial statements normally exhibit the following attributes that result in information provided in financial statements that is useful to users:*
- (a) *Relevance, in that the information provided in the financial statements is relevant to the nature of the entity and the objective of the financial statements. (For example, in the case of a business enterprise that prepares general purpose financial statements, relevance is assessed in terms of the information necessary to meet the common information needs of a wide range of users in making economic decisions. These needs are ordinarily met by presenting fairly the financial position, financial performance and cash flows of the business enterprise.)*
  - (b) *Completeness, in that transactions and events, account balances and disclosures that could affect the fair presentation of the financial statements are not omitted.*
  - (c) *Reliability, in that the information provided in the financial statements:*
    - Reflects the economic substance of events and transactions and not merely their legal form; and*
    - Results in reasonably consistent evaluation, measurement, presentation and disclosure, when used in similar circumstances;*
  - (d) *Neutrality, in that it contributes to information in the financial statements that is free from bias; and*
  - (e) *Understandability, in that the information in the financial statements is clear and comprehensive and not subject to significantly different interpretation.*
45. *A conglomeration of accounting conventions devised to suit individual preferences is not an acceptable financial reporting framework for financial statements intended to address the common information needs of a wide range of users.*
46. *The description of the financial reporting framework in the financial statements includes information about the basis of preparation of the financial statements and the accounting policies selected and applied for significant transactions and other significant events.*
47. *The auditor may decide to compare the accounting conventions to the requirements of an existing framework considered to be acceptable such as, for example IFRSs promulgated by the International Accounting Standards Board. For an audit of a small entity, the auditor may decide to compare such accounting conventions to a financial reporting framework specifically developed for such entities by an authorized or recognized standards setting organization. When the auditor makes such a comparison*

*and differences are identified, the decision as to whether the accounting conventions adopted by management constitute an acceptable financial reporting framework includes consideration of the reasons for the differences and whether application of the accounting conventions could result in financial statements that are misleading.*

48. *When the auditor concludes that the financial reporting framework adopted by management is not acceptable, the auditor considers the implications in relation to engagement acceptance (see ISA 210) and the auditor's report (see ISA 701).*
2. Paragraphs 50 and 51 of ISA 200, "Objective and General Principles Governing an Audit of Financial Statements" have not been adopted in HKSA 200, and are shown below for reference

50. *The auditor refers to ISA 800 when expressing an opinion on:*

- (a) A complete set of financial statements prepared in accordance with another comprehensive basis of accounting;*
- (b) A component of a complete set of general purpose or special purpose financial statements, such as a single financial statement, specified accounts, elements of accounts, or items in a financial statement;*
- (c) Compliance with contractual agreements; and*
- (d) Summarized financial statements.*

51. *In addition to addressing reporting considerations, ISA 800 also addresses other matters the auditor considers in such engagements related to, for example, engagement acceptance and the conduct of the audit.*

The HKICPA has not adopted the current ISA 800. The current ISA 800 allows a true and fair view opinion to be expressed by a practitioner in situations described in (a) and (b) above. ISA 800 is currently under revision by the IAASB and revised ISA 800 will be considered for adoption by the HKICPA.