

HKSA 701
Issued October 2006

Effective for auditor's reports dated
on or after 31 December 2006

Hong Kong Standard on Auditing 701

Modifications to the Independent Auditor's Report



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

HONG KONG STANDARD ON AUDITING 701
MODIFICATIONS TO THE INDEPENDENT
AUDITOR'S REPORT

(Effective for auditor's reports
dated on or after 31 December 2006)*

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Hong Kong Standard on Auditing (HKSA) 701, "Modifications to the Independent Auditor's Report" 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.

* This HKSA establishes standards and provides guidance to be applied when the independent auditor's report should be modified. HKSA 700, "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements" establishes standards and provides guidance to be applied when the auditor is able to express an unqualified opinion and no modification to the auditor's report is necessary. Both HKSAs are effective for auditor's reports dated on or after 31 December 2006.

Introduction

1. The purpose of this Hong Kong Standard on Auditing (HKSA) is to establish standards and provide guidance on the circumstances when the independent auditor's report should be modified and the form and the content of the modifications to the auditor's report in those circumstances.
2. HKSA 700, "The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements" establishes standards and provides guidance on the form and content of the independent auditor's report on a complete set of general purpose financial statements prepared in accordance with a financial reporting framework designed to achieve fair presentation when the auditor is able to express an unqualified opinion and no modification to the auditor's report is necessary. This HKSA describes how the auditor's report wording is 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.
3. Uniformity in the form and content of each type of modified report will further the user's understanding of such reports. Accordingly, this HKSA includes suggested wording of modifying phrases for use when issuing modified reports.
 4. The illustrative reports in this HKSA are based on the auditor's report on general purpose financial statements for a business enterprise. The principles relating to the circumstances when the auditor's report needs to be modified are, however, also applicable to reports on other engagements related to the audit of historical financial information, such as general purpose financial statements for entities of a different nature (for example, a not-for-profit organization).

Matters that Do Not Affect the Auditor's Opinion

5. 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 paragraph containing the auditor's opinion but before the section on any other reporting responsibilities, if any. The emphasis of matter paragraph would ordinarily refer to the fact that the auditor's opinion is not qualified in this respect.
6. **The auditor should modify the auditor's report by adding a paragraph to highlight a material matter regarding a going concern problem.**
7. **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.
8. An illustration of an emphasis of matter paragraph for a significant uncertainty in an auditor's report follows:

"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 HKSA 570, “Going Concern.”)

9. 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.
10. 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 paragraph containing the auditor’s opinion but before the section on any other reporting responsibilities, if any, 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

11. 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 16-21.
12. **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.**
13. **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.**
14. **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.**
15. **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 on the financial statements 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

16. 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.
17. 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.
18. **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.**
19. 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 – see paragraph 60 of HKSA 700).

Management is responsible for ... (remaining words are the same as illustrated in the management's responsibility paragraph – see paragraph 60 of HKSA 700).

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 auditor's responsibility paragraphs – see paragraph 60 of HKSA 700).

We did not observe the counting of the physical inventories as of 31 December 200X, 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, 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 financial statements give a true and fair view of ... (remaining words are the same as illustrated in the opinion paragraph – paragraph 60 of HKSA 700)."

Limitation on Scope—Disclaimer of Opinion

"We were engaged to audit the accompanying financial statements of ABC Company, which comprise the balance sheet as of 31 December 200X, 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 ... (remaining words are the same as illustrated in the management's responsibility paragraph – see paragraph 60 of HKSA 700).

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

(The paragraph discussing the scope of the audit would either be omitted or amended according to the circumstances.)

(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.”

Disagreement with Management

20. 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.**
21. 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 – see paragraph 60 of HKSA 700).

Management is responsible for ... (remaining words are the same as illustrated in the management’s responsibility paragraph – see paragraph 60 of HKSA 700).

Our responsibility is to ... (remaining words are the same as illustrated in the auditor’s responsibility paragraphs – see paragraph 60 of HKSA 700).

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 Hong Kong Financial Reporting Standards. The provision for the year ended 31 December 200X, 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, except for the effect on the financial statements of the matter referred to in the preceding paragraph, the financial statements give a true and fair view of ... (remaining words are the same as illustrated in the opinion paragraph – see paragraph 60 of HKSA 700).”

Disagreement on Accounting Policies—Inadequate Disclosure—Qualified Opinion

“We have audited ... (remaining words are the same as illustrated in the introductory paragraph – see paragraph 60 of HKSA 700).

Management is responsible for ... (remaining words are the same as illustrated in the management’s responsibility paragraph – see paragraph 60 of HKSA 700 (Revised)).

Our responsibility is to ... (remaining words are the same as illustrated in the auditor’s responsibility paragraphs – see paragraph 60 of HKSA 700 (Revised)).

^(a) In Hong Kong, an auditor of a company incorporated under the Hong Kong Companies Ordinance has a statutory duty to make a report to the members of the company on the company’s annual financial statements. Accordingly, an auditor in Hong Kong adheres to the requirements under paragraphs 32 and 34 of HKSA 700 which require that the auditor’s report should state the auditor’s responsibility and give details of the basis of an audit. An illustration is provided in Example 3 of the Appendix to reflect the auditor’s duty under the Hong Kong Companies Ordinance.

On 15 January 2005, 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 31 December 2000. In our opinion, disclosure of this information is required by ...¹

In our opinion, except for the omission of the information included in the preceding paragraph, the financial statements give a true and fair view of ... (remaining words are the same as illustrated in the opinion paragraph—see paragraph 60 of HKSA 700)."

Disagreement on Accounting Policies—Inadequate Disclosure—Adverse Opinion

"We have audited ... (remaining words are the same as illustrated in the introductory paragraph – see paragraph 60 of HKSA 700).

Management is responsible for ... (remaining words are the same as illustrated in the management's responsibility paragraph – see paragraph 60 of HKSA 700).

Our responsibility is to ... (remaining words are the same as illustrated in the auditor's responsibility paragraphs – see paragraph 60 of HKSA 700).

(Paragraph(s) discussing the disagreement.)

In our opinion, 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 (or 'do not present fairly, in all material respects,') the financial position of ABC Company as of 31 December 200X, and of its financial performance and its cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards."

Effective Date

22. This HKSA is effective for auditor's reports dated on or after 31 December 2006.

Conformity and compliance with International Standards on Auditing

23. As of October 2006 (date of issue) this HKSA conforms with International Standard on Auditing (ISA) 701, "Modifications to the Independent Auditor's Report" except that in paragraph 19, for a disclaimer of opinion, ISA 701 permits the omission of the paragraph stating the responsibility of the auditor. With the exception of the foregoing difference, as explained in footnote (a), compliance with the requirements of the HKSA ensures compliance with ISA 701.
24. Additional local guidance is provided in footnote (a) and the Appendix.

¹ Refer to relevant statutes or law.

Appendix

Examples of modified auditors' reports on financial statements

Matters that do affect the auditor's opinion

Example 1 – Qualified opinion – disagreement with management

Example 2 – Qualified opinion – limitation on the auditor's work

Example 3 – Disclaimer of opinion – limitation on the auditor's work

Example 4 – Adverse opinion – disagreement with management

Example 1 – Qualified opinion – disagreement with management

**INDEPENDENT AUDITOR'S REPORT
TO THE SHAREHOLDERS OF ABC LIMITED**

(incorporated in Hong Kong with limited liability)¹

We have audited the financial statements of ABC Limited set out on pages to, which comprise the balance sheet as at 31 December 200X, and the income statement, [statement of changes in equity or statement of recognised income and expense] and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the financial statements

The directors are responsible for the preparation and the true and fair presentation of these financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true 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.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit². We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Basis for qualified opinion

Included in debtors shown on the balance sheet is an amount of \$X due from a debtor which has ceased trading. ABC Limited has no security for this debt. On the basis that no security has been obtained and no cash has been received on the debt, in our opinion the company should make a full provision for impairment of \$X, reducing profit before taxation for the year and net assets at 31 December 200X by that amount.

¹ In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

² Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".

Qualified opinion arising from disagreement about accounting treatment

In our opinion, except for the effect on the financial statements of the matter described in the basis for qualified opinion paragraph, the financial statements give a true and fair view of the state of the company's affairs as at 31 December 200X and of its profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

XYZ & Co.

Certified Public Accountants (Practising) [or Certified Public Accountants]

[Address]

Date

Example 2 – Qualified opinion - limitation on the auditors' work

**INDEPENDENT AUDITOR'S REPORT
TO THE SHAREHOLDERS OF ABC LIMITED**

(incorporated in Hong Kong with limited liability)¹

Report on the Financial Statements

We have audited the financial statements of ABC Limited set out on pages to....., which comprise the balance sheet as at 31 December 200X, and the income statement, [statement of changes in equity or statement of recognised income and expense] and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the financial statements

The directors are responsible for the preparation and the true and fair presentation of these financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true 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.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit². Except as described in the basis for qualified opinion paragraph, we conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

¹ In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

² Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".

Basis for qualified opinion

\$X of the company's recorded turnover comprises cash sales, over which there was no system of internal control on which we could rely for the purpose of our audit. There were no other satisfactory audit procedures that we could adopt to satisfy ourselves that the recorded turnover was free from material misstatements.

Qualified opinion arising from limitation of audit scope

In our opinion, 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 cash sales, the financial statements give a true and fair view of the state of the company's affairs as at 31 December 200X and of its profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

Report on matters under sections 141(4) and 141(6) of the Hong Kong Companies Ordinance³

In respect alone of the limitation on our work relating to cash sales:

- we have not obtained all the information and explanations that we considered necessary for the purpose of our audit; and
- we were unable to determine whether proper books of account had been kept.

XYZ & Co.

Certified Public Accountants (Practising) [or Certified Public Accountants]

[Address]

Date

³ For the requirements under the Hong Kong Companies Ordinance, reference may be made to PN 600.1 "Reports by auditors under the Hong Kong Companies Ordinance".

Example 3 – Disclaimer of opinion - limitation on the auditor's work

**INDEPENDENT AUDITOR'S REPORT
TO THE SHAREHOLDERS OF ABC LIMITED**

(incorporated in Hong Kong with limited liability)¹

Report on the Financial Statements

We were engaged to audit the financial statements of ABC Limited set out on pages to....., which comprise the balance sheet as at 31 December 200X, and the income statement, [statement of changes in equity or statement of recognised income and expense] and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the financial statements

The directors are responsible for the preparation and the true and fair presentation of these financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true 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.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit.² Except for the limitation in the scope of our work as explained below, we conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement. However, because of the matter described in the basis for disclaimer of opinion paragraph, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

We were initially appointed auditors on (date) which was subsequent to the end of the company's financial year. In consequence we were unable to carry out auditing procedures necessary to obtain adequate assurance regarding the quantities and condition of inventories and work in progress, appearing in the balance sheet at \$X. There were no other satisfactory audit procedures that we could adopt to obtain sufficient evidence regarding the existence of inventories and work in progress. Accordingly, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Any adjustment to the figure may have a consequential significant effect on the profit [loss] for the year and net assets at 31 December 200X.

¹ In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

² Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".

Disclaimer of opinion: disclaimer on view given by financial statements³

Because of the significance of the matters described in the basis for disclaimer of opinion paragraph, we do not express an opinion on the financial statements as to whether they give a true and fair view of the state of the company's affairs as at 31 December 200X and of its profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards. In all other respects, in our opinion the financial statements have been properly prepared in accordance with the Hong Kong Companies Ordinance.

Report on matters under sections 141(4) and 141(6) of the Hong Kong Companies Ordinance⁴

In respect alone of the limitation on our work relating to inventories and work in progress:

- we have not obtained all the information and explanations that we considered necessary for the purpose of our audit; and
- we were unable to determine whether proper books of account had been kept.

XYZ & Co.

Certified Public Accountants (Practising) [or Certified Public Accountants]

[Address]

Date

³ In this example, it is assumed that the counting of physical inventories 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. If the limitation of scope is not considered so material and pervasive, the auditor may express an "except for" opinion as illustrated in paragraph 19 of this HKSA.

⁴ For the requirements under the Hong Kong Companies Ordinance, reference may be made to PN 600.1 "Reports by auditors under the Hong Kong Companies Ordinance".

Example 4 – Adverse opinion – disagreement with management

**INDEPENDENT AUDITOR'S REPORT
TO THE SHAREHOLDERS OF ABC LIMITED**

(incorporated in Hong Kong with limited liability)¹

We have audited the financial statements of ABC Limited set out on pages to....., which comprise the balance sheet as at 31 December 200X, and the income statement, [statement of changes in equity or statement of recognised income and expense] and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' responsibility for the financial statements

The directors are responsible for the preparation and the true and fair presentation of these financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true 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.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit². We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Basis for adverse opinion

As more fully explained in note ... to the financial statements, losses expected to arise on certain long-term contracts currently in progress have not been recognised as expenses, as the directors consider that such losses should be off-set against amounts recoverable on other long-term contracts. In our opinion, the expected losses on individual contracts should be recognised as expenses immediately as required by Hong Kong Accounting Standard 11 "Construction Contracts". If losses had been so

¹ In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

² Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".

recognised the effect would have been to [reduce the profit/increase the loss] before taxation for the year and reduce the gross amounts due from customers at 31 December 200X by \$X.

Adverse opinion

In our opinion, because of the significance of effects of the matters described in the basis for adverse opinion paragraph, the financial statements do not give a true and fair view of the state of the company's affairs as at 31 December 200X and of its profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards. In all other respects, in our opinion the financial statements have been properly prepared in accordance with the Hong Kong Companies Ordinance.

XYZ & Co.

Certified Public Accountants (Practising) [or Certified Public Accountants]

[Address]

Date