

Effective for audits of financial statements
for periods beginning on or after 15 December 2009

Hong Kong Standard on Auditing 706

Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report

* There are amendments attached to this HKSA resulting from the Hong Kong Companies Ordinance (Cap. 622) which became effective on 3 March 2014. The amendments apply to the first financial year of companies that begins on or after the commencement date of the new Companies Ordinance and all subsequent financial years (i.e. typically the first set of financial statements covered would be for a financial period ending on or after 2 March 2015. Generally, for companies incorporated prior to 3 March 2014 with a calendar year end, the first applicable financial period is for the year ending 31 December 2015).



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HONG KONG STANDARD ON AUDITING 706

EMPHASIS OF MATTER PARAGRAPHS AND OTHER MATTER PARAGRAPHS IN THE INDEPENDENT AUDITOR'S REPORT

(Effective for audits of financial statements for periods beginning on or after 15 December 2009)

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Hong Kong Standard on Auditing (HKSA) 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report" should be read in conjunction with HKSA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing."

Introduction

Scope of this HKSA

1. This Hong Kong Standard on Auditing (HKSA) deals with additional communication in the auditor's report when the auditor considers it necessary to:
 - (a) Draw users' attention to a matter or matters presented or disclosed in the financial statements that are of such importance that they are fundamental to users' understanding of the financial statements; or
 - (b) Draw users' attention to any matter or matters other than those presented or disclosed in the financial statements that are relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.
2. Appendices 1 and 2 identify HKSAs that contain specific requirements for the auditor to include Emphasis of Matter paragraphs or Other Matter paragraphs in the auditor's report. In those circumstances, the requirements in this HKSA regarding the form and placement of such paragraphs apply.

Effective Date

3. This HKSA is effective for audits of financial statements for periods beginning on or after 15 December 2009.

Objective

4. The objective of the auditor, having formed an opinion on the financial statements, is to draw users' attention, when in the auditor's judgment it is necessary to do so, by way of clear additional communication in the auditor's report, to:
 - (a) A matter, although appropriately presented or disclosed in the financial statements, that is of such importance that it is fundamental to users' understanding of the financial statements; or
 - (b) As appropriate, any other matter that is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

Definitions

5. For purposes of the HKSAs, the following terms have the meanings attributed below:
 - (a) Emphasis of Matter paragraph – A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.
 - (b) Other Matter paragraph – A paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

Requirements

Emphasis of Matter Paragraphs in the Auditor's Report

6. If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements. Such a paragraph shall refer only to information presented or disclosed in the financial statements. (Ref: Para. A1-A2)
7. When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall:
 - (a) Include it immediately after the Opinion paragraph in the auditor's report;
 - (b) Use the heading "Emphasis of Matter," or other appropriate heading;
 - (c) Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements; and
 - (d) Indicate that the auditor's opinion is not modified in respect of the matter emphasized. (Ref: Para. A3-A4)

Other Matter Paragraphs in the Auditor's Report

8. If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report and this is not prohibited by law or regulation, the auditor shall do so in a paragraph in the auditor's report, with the heading "Other Matter," or other appropriate heading. The auditor shall include this paragraph immediately after the Opinion paragraph and any Emphasis of Matter paragraph, or elsewhere in the auditor's report if the content of the Other Matter paragraph is relevant to the Other Reporting Responsibilities section. (Ref: Para. A5-A11)

Communication with Those Charged with Governance

9. If the auditor expects to include an Emphasis of Matter or an Other Matter paragraph in the auditor's report, the auditor shall communicate with those charged with governance regarding this expectation and the proposed wording of this paragraph. (Ref: Para. A12)

Conformity and Compliance with International Standards on Auditing

10. As of September 2009 (date of issue), this HKSA conforms with International Standard on Auditing (ISA) 706 "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report". Compliance with the requirements of this HKSA ensures compliance with ISA 706.
11. Additional local guidance is provided in Appendix 3.

Application and Other Explanatory Material

Emphasis of Matter Paragraphs in the Auditor's Report

Circumstances in Which an Emphasis of Matter Paragraph May Be Necessary (Ref: Para. 6)

- A1. Examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are:
- An uncertainty relating to the future outcome of exceptional litigation or regulatory action.
 - Early application (where permitted) of a new accounting standard (for example, a new Hong Kong Financial Reporting Standard) that has a pervasive effect on the financial statements in advance of its effective date.
 - A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.
- A2. A widespread use of Emphasis of Matter paragraphs diminishes the effectiveness of the auditor's communication of such matters. Additionally, to include more information in an Emphasis of Matter paragraph than is presented or disclosed in the financial statements may imply that the matter has not been appropriately presented or disclosed; accordingly, paragraph 6 limits the use of an Emphasis of Matter paragraph to matters presented or disclosed in the financial statements.

Including an Emphasis of Matter Paragraph in the Auditor's Report (Ref: Para. 7)

- A3. The inclusion of an Emphasis of Matter paragraph in the auditor's report does not affect the auditor's opinion. An Emphasis of Matter paragraph is not a substitute for either:
- (a) The auditor expressing a qualified opinion or an adverse opinion, or disclaiming an opinion, when required by the circumstances of a specific audit engagement (see HKSA 705¹); or
 - (b) Disclosures in the financial statements that the applicable financial reporting framework requires management to make.
- A4. The illustrative report in Appendix 3 includes an Emphasis of Matter paragraph in an auditor's report that contains a qualified opinion.

Other Matter Paragraphs in the Auditor's Report

 (Ref: Para. 8)

Circumstances in Which an Other Matter Paragraph May Be Necessary

Relevant to Users' Understanding of the Audit

- A5. In the rare circumstance where the auditor is unable to withdraw from an engagement even though the possible effect of an inability to obtain sufficient appropriate audit evidence due to a limitation on the scope of the audit imposed by management is pervasive,² the auditor may consider it necessary to include an Other Matter paragraph in the auditor's report to explain why it is not possible for the auditor to withdraw from the engagement.

¹ HKSA 705, "Modifications to the Opinion in the Independent Auditor's Report."

² See paragraph 13(b)(ii) of HKSA 705 for a discussion of this circumstance.

Relevant to Users' Understanding of the Auditor's Responsibilities or the Auditor's Report

- A6. Law, regulation or generally accepted practice in a jurisdiction may require or permit the auditor to elaborate on matters that provide further explanation of the auditor's responsibilities in the audit of the financial statements or of the auditor's report thereon. Where relevant, one or more sub-headings may be used that describe the content of the Other Matter paragraph.
- A7. An Other Matter paragraph does not deal with circumstances where the auditor has other reporting responsibilities that are in addition to the auditor's responsibility under the HKSA's to report on the financial statements (see "Other Reporting Responsibilities" section in HKSA 700³), or where the auditor has been asked to perform and report on additional specified procedures, or to express an opinion on specific matters.

Reporting on more than one set of financial statements

- A8. An entity may prepare one set of financial statements in accordance with a general purpose framework (for example, Hong Kong Financial Reporting Standards) and another set of financial statements in accordance with another general purpose framework (for example, International Financial Reporting Standards), and engage the auditor to report on both sets of financial statements. If the auditor has determined that the frameworks are acceptable in the respective circumstances, the auditor may include an Other Matter paragraph in the auditor's report, referring to the fact that another set of financial statements has been prepared by the same entity in accordance with another general purpose framework and that the auditor has issued a report on those financial statements.

Restriction on distribution or use of the auditor's report

- A9. Financial statements prepared for a specific purpose may be prepared in accordance with a general purpose framework because the intended users have determined that such general purpose financial statements meet their financial information needs. Since the auditor's report is intended for specific users, the auditor may consider it necessary in the circumstances to include an Other Matter paragraph, stating that the auditor's report is intended solely for the intended users, and should not be distributed to or used by other parties.

Including an Other Matter Paragraph in the Auditor's Report

- A10. The content of an Other Matter paragraph reflects clearly that such other matter is not required to be presented and disclosed in the financial statements. An Other Matter paragraph does not include information that the auditor is prohibited from providing by law, regulation or other professional standards, for example, ethical standards relating to confidentiality of information. An Other Matter paragraph also does not include information that is required to be provided by management.
- A11. The placement of an Other Matter paragraph depends on the nature of the information to be communicated. When an Other Matter paragraph is included to draw users' attention to a matter relevant to their understanding of the audit of the financial statements, the paragraph is included immediately after the Opinion paragraph and any Emphasis of Matter paragraph. When an Other Matter paragraph is included to draw users' attention to a matter relating to Other Reporting Responsibilities addressed in the auditor's report, the paragraph may be included in the section sub-titled "Report on Other Legal and Regulatory Requirements." Alternatively, when relevant to all the auditor's responsibilities or users' understanding of the auditor's report, the Other Matter paragraph may be included as a separate section following the Report on the Financial Statements and the Report on Other Legal and Regulatory Requirements.

³ HKSA 700, "Forming an Opinion and Reporting on Financial Statements," paragraphs 38-39

Communication with Those Charged with Governance (Ref. Para. 9)

- A12. Such communication enables those charged with governance to be made aware of the nature of any specific matters that the auditor intends to highlight in the auditor's report, and provides them with an opportunity to obtain further clarification from the auditor where necessary. Where the inclusion of an Other Matter paragraph on a particular matter in the auditor's report recurs on each successive engagement, the auditor may determine that it is unnecessary to repeat the communication on each engagement.

Appendix 1

(Ref: Para. 2)

List of HKSAs Containing Requirements for Emphasis of Matter Paragraphs

This appendix identifies paragraphs in other HKSAs in effect for audits of financial statements for periods beginning on or after 15 December 2009 that require the auditor to include an Emphasis of Matter paragraph in the auditor's report in certain circumstances. The list is not a substitute for considering the requirements and related application and other explanatory material in HKSAs.

- HKSA 210, "Agreeing the Terms of Audit Engagements" – paragraph 19(b)
- HKSA 560, "Subsequent Events" – paragraphs 12(b) and 16
- HKSA 570, "Going Concern" – paragraph 19
- HKSA 800, "Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks" – paragraph 14

Appendix 2

(Ref: Para. 2)

List of HKSAs Containing Requirements for Other Matter Paragraphs

This appendix identifies paragraphs in other HKSAs in effect for audits of financial statements for periods beginning on or after 15 December 2009 that require the auditor to include an Other Matter paragraph in the auditor's report in certain circumstances. The list is not a substitute for considering the requirements and related application and other explanatory material in HKSAs.

- HKSA 560, "Subsequent Events" – paragraphs 12(b) and 16
- HKSA 710, "Comparative Information—Corresponding Figures and Comparative Financial Statements" – paragraphs 13-14, 16-17 and 19
- HKSA 720, "The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements" – paragraph 10(a)

Appendix 3

(Ref: Para. A4)

Illustration of an Auditor's Report that Includes an Emphasis of Matter Paragraph

Circumstances include the following:

- **Audit of a complete set of general purpose financial statements prepared by the directors of the entity in accordance with Hong Kong Financial Reporting Standards.**
- **The terms of the audit engagement reflect the description of directors' responsibility for the financial statements in HKSA 210.¹**
- **There is uncertainty relating to a pending exceptional litigation matter.**
- **A departure from the applicable financial reporting framework resulted in a qualified opinion.**
- **In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance.**

INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)^{1a}

[Report on the Financial Statements]²

We have audited the financial statements of ABC Limited ("the Company") set out on pages to, which comprise the [balance sheet][statement of financial position]^{2a} as at 31 December 20X1, and the [income statement][statement of comprehensive income]^{2a}, statement of changes in equity and [cash flow statement][statement of cash flows]^{2a} for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors'³ Responsibility for the Financial Statements

The directors are responsible for the preparation of financial statements that give a true and fair view in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

¹ HKSA 210, "Agreeing the Terms of Audit Engagements."

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

² The sub-title "Report on the Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

^{2a} Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

³ Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

⁴ Not used.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit^{4a}. 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 about 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 of financial statements that give a true and fair view 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.⁶ 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 that we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Basis for Qualified Opinion

The Company's short-term marketable securities are carried in the [balance sheet][statement of financial position]^{2a} at xxx. The directors have not marked these securities to market but have instead stated them at cost, which constitutes a departure from Hong Kong Financial Reporting Standards. The Company's records indicate that had the directors marked the marketable securities to market, the Company would have recognized an unrealized loss of xxx in the [income statement][statement of comprehensive income]^{2a} for the year. The carrying amount of the securities in the [balance sheet][statement of financial position]^{2a} would have been reduced by the same amount at 31 December 20X1, and income tax, net income and shareholders' equity would have been reduced by xxx, xxx and xxx, respectively.

Qualified Opinion

In our opinion, except for the effects 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 20X1, and of its [profit][loss] 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.

Emphasis of Matter

We draw attention to Note X to the financial statements which describes the uncertainty⁷ related to the outcome of the lawsuit filed against the Company by DEF Company. Our opinion is not qualified in respect of this matter.

^{4a} 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".

⁵ Not used.

⁶ In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances."

⁷ In highlighting the uncertainty, the auditor uses the same terminology that is used in the note to the financial statements.

[Report on Other Legal and Regulatory Requirements]

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]]²

XYZ & Co.

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

[Auditor's address]

Date of the auditor's report

AMENDMENTS RESULTING FROM THE HONG KONG COMPANIES ORDINANCE (CAP. 622)

Note: The following sets out the amended text required for this Standard resulting from Hong Kong Companies Ordinance (Cap. 622) which became effective on 3 March 2014. The amended text apply to the first financial year of companies that begins on or after the commencement date of the new Companies Ordinance and all subsequent financial years (i.e. typically the first set of financial statements covered would be for a financial period ending on or after 2 March 2015. Generally, for companies incorporated prior to 3 March 2014 with a calendar year end, the first applicable financial period is for the year ending 31 December 2015).

Appendix 3

(Ref: Para. A4)

Illustration of an Auditor's Report that Includes an Emphasis of Matter Paragraph

Circumstances include the following:

- **Audit of a complete set of general purpose financial statements prepared by the directors of the entity in accordance with Hong Kong Financial Reporting Standards.**
- **The terms of the audit engagement reflect the description of directors' responsibility for the financial statements in HKSA 210.¹**
- **There is uncertainty relating to a pending exceptional litigation matter.**
- **A departure from the applicable financial reporting framework resulted in a qualified opinion.**
- **In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance.**

INDEPENDENT AUDITOR'S REPORT

TO THE MEMBERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)^{1a}

[Report on the Financial Statements]²

We have audited the financial statements of ABC Limited ("the Company") set out on pages to, which comprise the statement of financial position as at 31 December 20X1, and the [statement of profit or loss and]^{2a} statement of profit or loss and other comprehensive income.

¹ HKSA 210, "Agreeing the Terms of Audit Engagements"

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

² The sub-title "Report on the Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

^{2a} HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.

statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors'³ Responsibility for the Financial Statements

The directors are responsible for the preparation of financial statements that give a true and fair view in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit^{4a}. 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 about 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 of financial statements that give a true and fair view 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.⁶ 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 qualified audit opinion.

Basis for Qualified Opinion

The Company's short-term marketable securities are carried in the statement of financial position at xxx. The directors have not marked these securities to market but have instead stated them at cost, which constitutes a departure from Hong Kong Financial Reporting Standards. The Company's records indicate that had the directors marked the marketable securities to market, the Company would have recognized an unrealized loss of xxx in [the statement of profit or loss and]^{2a} the statement of profit or loss and other comprehensive income for the year. The carrying amount of the securities in the statement of financial position would have been reduced by the same amount at 31 December 20X1, and income tax, net income and shareholders' equity would have been reduced by xxx, xxx and xxx, respectively.

³ Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

⁴ Not used.

^{4a} 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".

⁵ Not used.

⁶ In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances."

EMPHASIS OF MATTER PARAGRAPHS AND OTHER MATTER PARAGRAPHS
IN THE INDEPENDENT AUDITOR'S REPORT

Qualified Opinion

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements give a true and fair view of the financial position of the Company as at 31 December 20X1, and of its financial performance and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Emphasis of Matter

We draw attention to Note X to the financial statements which describes the uncertainty⁷ related to the outcome of the lawsuit filed against the Company by DEF Company. Our opinion is not qualified in respect of this matter.

[Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]²

XYZ & Co.

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

[Auditor's address]

Date of the auditor's report

⁷ In highlighting the uncertainty, the auditor uses the same terminology that is used in the note to the financial statements.