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

MEMBERS' HANDBOOK

Update No. 226

(Issued 30 January 2019)

Document Reference and Title	***Instructions***	***Explanations***
VOLUME III		
Contents of Volume III	Discard the existing pages i - iv and replace with the revised pages i - iv.	Revised contents pages
HONG KONG STANDARDS ON QUALITY CONTROL		
HKSQC 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*	Replace cover page, pages 2 and 27 with revised cover page, pages 2 and 27.	Note 1
HONG KONG STANDARDS ON AUDITING		
HKSA 210 *Agreeing the Terms of Audit Engagements*	Replace cover page, pages 2 and 14 with revised cover page, pages 2 and 14.	- ditto -
HKSA 220 *Quality Control for an Audit of Financial Statements*	Discard HKSA 220 revised in June 2017 and replace with the revised HKSA 220.	- ditto -
HKSA 240 *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*	Discard HKSA 240 revised in June 2017 and replace with the revised HKSA 240.	- ditto -
HKSA 250 (Clarified) *Consideration of Laws and Regulations in an Audit of Financial Statements*	Discard HKSA 250 (Clarified) revised in July 2010.	- ditto -
HKSA 250 (Revised) *Consideration of Laws and Regulations in an Audit of Financial Statements*	Replace cover page with revised cover page and discard pages 19 – 31.	- ditto -
HKSA 260 (Revised) *Communication with Those Charged with Governance*	Replace cover page, pages 2, 5, 8 and 22 with revised cover page, pages 2, 5, 8 and 22.	- ditto -

HKSA 450 *Evaluation of Misstatements Identified During the Audit*	Replace cover page, pages 2, 3, 5, 6 and 9 with revised cover page, pages 2, 3, 5, 6 and 9.	- ditto -
HKSA 500 *Audit Evidence*	Discard HKSA 500 revised in June 2017 and replace with the revised HKSA 500.	- ditto -

HONG KONG STANDARDS ON REVIEW ENGAGEMENTS

HKSRE 2400 (Revised) *Engagements to Review Historical Financial Statements*	Discard HKSRE 2400 (Revised) issued in December 2012 and replace with the revised HKSRE 2400 (Revised).	- ditto -

HONG KONG STANDARDS ON ASSURANCE ENGAGEMENTS

HKSAE 3000 (Revised) *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*	Discard HKSAE 3000 (Revised) revised in February 2015 and replace with the revised HKSAE 3000 (Revised).	- ditto -
HKSAE 3402 *Assurance Reports on Controls at a Service Organization*	Discard HKSAE 3402 revised in March 2014 and replace with the revised HKSAE 3402.	Notes 1, 2
HKSAE 3410 *Assurance Engagements on Greenhouse Gas Statements*	Discard HKSAE 3410 revised in March 2014 and replace with the revised HKSAE 3410.	- ditto -

HONG KONG STANDARDS ON RELATED SERVICES

HKSRS 4410 (Revised) *Compilation Engagements*	Discard HKSRS 4410 (Revised) revised in July 2012 and replace with the revised HKSRS 4410 (Revised).	Note 1

Notes:

1. Conforming amendments as a result of HKSA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements* have been updated to the relevant standards. These conforming amendments are effective for audits of financial statements for periods beginning on or after 15 December 2017.

2. Conforming amendments as a result of HKSAE 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information* have been updated to the relevant standards. These conforming amendments are effective for assurance engagements where the assurance report is dated on or after 15 December 2015.

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MEMBERS' HANDBOOK
CONTENTS OF VOLUME III

(Updated to January 2019)

		Issue/Review date

HKSQC 1
Issued June 2009; revised July 2010, May 2013, February 2015, January 2019

Effective as of 15 December 2009

Hong Kong Standard on Quality Control 1

Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements

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Considerations specific to public sector audit organizations

A51. In the public sector, a statutorily appointed auditor (for example, an Auditor General, or other suitably qualified person appointed on behalf of the Auditor General) may act in a role equivalent to that of engagement partner with overall responsibility for public sector audits. In such circumstances, where applicable, the selection of the engagement quality control reviewer includes consideration of the need for independence from the audited entity and the ability of the engagement quality control reviewer to provide an objective evaluation.

Differences of Opinion (Ref: Para. 43)

A52. Effective procedures encourage identification of differences of opinion at an early stage, provide clear guidelines as to the successive steps to be taken thereafter, and require documentation regarding the resolution of the differences and the implementation of the conclusions reached.

A53. Procedures to resolve such differences may include consulting with another practitioner or firm, or a professional or regulatory body.

Engagement Documentation

Completion of the Assembly of Final Engagement Files (Ref: Para. 45)

A54. Law or regulation may prescribe the time limits by which the assembly of final engagement files for specific types of engagement is to be completed. Where no such time limits are prescribed in law or regulation, paragraph 45 requires the firm to establish time limits that reflect the need to complete the assembly of final engagement files on a timely basis. In the case of an audit, for example, such a time limit would ordinarily not be more than 60 days after the date of the auditor's report.

A55. Where two or more different reports are issued in respect of the same subject matter information of an entity, the firm's policies and procedures relating to time limits for the assembly of final engagement files address each report as if it were for a separate engagement. This may, for example, be the case when the firm issues an auditor's report on a component's financial information for group consolidation purposes and, at a subsequent date, an auditor's report on the same financial information for statutory purposes.

Confidentiality, Safe Custody, Integrity, Accessibility and Retrievability of Engagement Documentation (Ref: Para. 46)

A56. Relevant ethical requirements establish an obligation for the firm's personnel to observe at all times the confidentiality of information contained in engagement documentation, unless specific client authority has been given to disclose information, or there are responsibilities under law, regulation or relevant ethical requirements to do so.[6] Specific laws or regulations may impose additional obligations on the firm's personnel to maintain client confidentiality, particularly where data of a personal nature are concerned.

A57. Whether engagement documentation is in paper, electronic or other media, the integrity, accessibility or retrievability of the underlying data may be compromised if the documentation could be altered, added to or deleted without the firm's knowledge, or if it could be permanently lost or damaged. Accordingly, controls that the firm designs and implements to avoid unauthorized alteration or loss of engagement documentation may include those that:

- Enable the determination of when and by whom engagement documentation was created, changed or reviewed;

[6] See, for example, Section 140.7 and Section 225.35 of the Code.

HKSA 210
Issued June 2009; revised July, October 2010, December 2012, June 2014, August 2015, January 2016, August 2016, June 2017, January 2019

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

Hong Kong Standard on Auditing 210

Agreeing the Terms of Audit Engagements

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- The expectation that management will provide access to all information of which management is aware that is relevant to the preparation of the financial statements, including an expectation that management will provide access to information relevant to disclosures.

- The agreement of management to make available to the auditor draft financial statements, including all information relevant to their preparation, whether obtained from within or outside of the general and subsidiary ledgers (including all information relevant to the preparation of disclosures), and the other information[19], if any, in time to allow the auditor to complete the audit in accordance with the proposed timetable.

- The agreement of management to inform the auditor of facts that may affect the financial statements, of which management may become aware during the period from the date of the auditor's report to the date the financial statements are issued.

- The basis on which fees are computed and any billing arrangements.

- A request for management to acknowledge receipt of the audit engagement letter and to agree to the terms of the engagement outlined therein.

A25. When the auditor is not required to communicate key audit matters, it may be helpful for the auditor to make reference in the terms of the audit engagement to the possibility of communicating key audit matters in the auditor's report and, in certain jurisdictions, it may be necessary for the auditor to include a reference to such possibility in order to retain the ability to do so.

A26. When relevant, the following points could also be made in the audit engagement letter:

- Arrangements concerning the involvement of other auditors and experts in some aspects of the audit.

- Arrangements concerning the involvement of internal auditors and other staff of the entity.

- Arrangements to be made with the predecessor auditor, if any, in the case of an initial audit.

- A reference to, and description of, the auditor's responsibilities under law, regulation or relevant ethical requirements that address reporting identified or suspected non-compliance with laws and regulations to an appropriate authority outside the entity.

- Any restriction of the auditor's liability when such possibility exists.

- A reference to any further agreements between the auditor and the entity.

- Any obligations to provide audit working papers to other parties.

An example of an audit engagement letter is set out in Appendix 1.

Audits of Components

A27. When the auditor of a parent entity is also the auditor of a component, the factors that may influence the decision whether to send a separate audit engagement letter to the component include the following:

- Who appoints the component auditor;

- Whether a separate auditor's report is to be issued on the component;

[19] As defined in HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*

HKSA 220
Issued June 2009; revised July 2010, May 2013,
February 2015, August 2015, June 2017, January 2019

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

Hong Kong Standard on Auditing 220

Quality Control for an Audit of Financial Statements

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HONG KONG STANDARD ON AUDITING 220
QUALITY CONTROL FOR AN AUDIT OF FINANCIAL STATEMENTS

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

CONTENTS

Hong Kong Standard on Auditing (HKSA) 220, *Quality Control for an Audit of Financial Statements*, 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 the specific responsibilities of the auditor regarding quality control procedures for an audit of financial statements. It also addresses, where applicable, the responsibilities of the engagement quality control reviewer. This HKSA is to be read in conjunction with relevant ethical requirements.

System of Quality Control and Role of Engagement Teams

2. Quality control systems, policies and procedures are the responsibility of the audit firm. Under HKSQC 1, the firm has an obligation to establish and maintain a system of quality control to provide it with reasonable assurance that:

   (a) The firm and its personnel comply with professional standards and applicable legal and regulatory requirements; and

   (b) Reports issued by the firm or engagement partners are appropriate in the circumstances.[1]

   This HKSA is premised on the basis that the firm is subject to HKSQC 1. (Ref: Para. A1)

3. Within the context of the firm's system of quality control, engagement teams have a responsibility to implement quality control procedures that are applicable to the audit engagement and provide the firm with relevant information to enable the functioning of that part of the firm's system of quality control relating to independence.

4. Engagement teams are entitled to rely on the firm's system of quality control, unless information provided by the firm or other parties suggests otherwise. (Ref: Para. A2)

Effective Date

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

Objective

6. The objective of the auditor is to implement quality control procedures at the engagement level that provide the auditor with reasonable assurance that:

   (a) The audit complies with professional standards and applicable legal and regulatory requirements; and

   (b) The auditor's report issued is appropriate in the circumstances.

[1] HKSQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*, paragraph 11

Definitions

7. For purposes of the HKSAs, the following terms have the meanings attributed below:

   (a) Engagement partner[2] – The partner or other person in the firm who is responsible for the audit engagement and its performance, and for the auditor's report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.

   (b) Engagement quality control review – A process designed to provide an objective evaluation, on or before the date of the auditor's report, of the significant judgments the engagement team made and the conclusions it reached in formulating the auditor's report. The engagement quality control review process is for audits of financial statements of listed entities and those other audit engagements, if any, for which the firm has determined an engagement quality control review is required.

   (c) Engagement quality control reviewer – A partner, other person in the firm, suitably qualified external person, or a team made up of such individuals, none of whom is part of the engagement team, with sufficient and appropriate experience and authority to objectively evaluate the significant judgments the engagement team made and the conclusions it reached in formulating the auditor's report.

   (d) Engagement team – All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform audit procedures on the engagement. This excludes an auditor's external expert engaged by the firm or a network firm.[3] The term "engagement team" also excludes individuals within the client's internal audit function who provide direct assistance on an audit engagement when the external auditor complies with the requirements of HKSA 610 (Revised 2013).[4]

   (e) Firm – A sole practitioner, partnership or corporation or other entity of professional accountants.

   (f) Inspection – In relation to completed audit engagements, procedures designed to provide evidence of compliance by engagement teams with the firm's quality control policies and procedures.

   (g) Listed entity – An entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or other equivalent body.

   (h) Monitoring – A process comprising an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements, designed to provide the firm with reasonable assurance that its system of quality control is operating effectively.

   (i) Network firm – A firm or entity that belongs to a network.

   (j) Network – A larger structure:

      (i) That is aimed at cooperation, and

[2] "Engagement partner," "partner," and "firm" should be read as referring to their public sector equivalents where relevant.

[3] HKSA 620, *Using the Work of an Auditor's Expert*, paragraph 6(a), defines the term "auditor's expert."

[4] HKSA 610 (Revised 2013), *Using the Work of Internal Auditors*, establishes limits on the use of direct assistance. It also acknowledges that the external auditor may be prohibited by law or regulation from obtaining direct assistance from internal auditors. Therefore, the use of direct assistance is restricted to situations where it is permitted.

(ii) That is clearly aimed at profit or cost-sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand name, or a significant part of professional resources.

(k) Partner – Any individual with authority to bind the firm with respect to the performance of a professional services engagement.

(l) Personnel – Partners and staff.

(m) Professional standards – HKICPA engagement standards, as defined in the HKICPA's *Preface to the Hong Kong Standards on Quality Control, Auditing, Review, Other Assurance and Related Services*, and relevant ethical requirements.

(n) Relevant ethical requirements – Ethical requirements to which the engagement team and engagement quality control reviewer are subject, which ordinarily comprise Parts A, B and D of the HKICPA's *Code of Ethics for Professional Accountants* (the Code) related to an audit of financial statements.

(o) Staff – Professionals, other than partners, including any experts the firm employs.

(p) Suitably qualified external person – An individual outside the firm with the competence and capabilities to act as an engagement partner, for example, a partner of another firm, or an employee (with appropriate experience) of either a professional accountancy body whose members may perform audits of historical financial information or of an organization that provides relevant quality control services.

Requirements

Leadership Responsibilities for Quality on Audits

8. The engagement partner shall take responsibility for the overall quality on each audit engagement to which that partner is assigned. (Ref: Para. A3)

Relevant Ethical Requirements

9. Throughout the audit engagement, the engagement partner shall remain alert, through observation and making inquiries as necessary, for evidence of non-compliance with relevant ethical requirements by members of the engagement team. (Ref: Para. A4-A5)

10. If matters come to the engagement partner's attention through the firm's system of quality control or otherwise that indicate that members of the engagement team have not complied with relevant ethical requirements, the engagement partner, in consultation with others in the firm, shall determine the appropriate action. (Ref: Para. A5)

Independence

11. The engagement partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, the engagement partner shall: (Ref: Para. A5)

    (a) Obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence;

(b) Evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and

(c) Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is possible under applicable law or regulation. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action. (Ref: Para. A6-A7)

Acceptance and Continuance of Client Relationships and Audit Engagements

12. The engagement partner shall be satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and audit engagements have been followed, and shall determine that conclusions reached in this regard are appropriate. (Ref: Para. A8-A10)

13. If the engagement partner obtains information that would have caused the firm to decline the audit engagement had that information been available earlier, the engagement partner shall communicate that information promptly to the firm, so that the firm and the engagement partner can take the necessary action. (Ref: Para. A10)

Assignment of Engagement Teams

14. The engagement partner shall be satisfied that the engagement team, and any auditor's experts who are not part of the engagement team, collectively have the appropriate competence and capabilities to:

    (a) Perform the audit engagement in accordance with professional standards and applicable legal and regulatory requirements; and

    (b) Enable an auditor's report that is appropriate in the circumstances to be issued. (Ref: Para. A11-A13)

Engagement Performance

Direction, Supervision and Performance

15. The engagement partner shall take responsibility for:

    (a) The direction, supervision and performance of the audit engagement in compliance with professional standards and applicable legal and regulatory requirements; and (Ref: Para. A15-A16, A21)

    (b) The auditor's report being appropriate in the circumstances.

Reviews

16. The engagement partner shall take responsibility for reviews being performed in accordance with the firm's review policies and procedures. (Ref: Para. A17-A18, A21)

17. On or before the date of the auditor's report, the engagement partner shall, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued. (Ref: Para. A19-A21)

Consultation

18. The engagement partner shall:

    (a) Take responsibility for the engagement team undertaking appropriate consultation on difficult or contentious matters;

    (b) Be satisfied that members of the engagement team have undertaken appropriate consultation during the course of the engagement, both within the engagement team and between the engagement team and others at the appropriate level within or outside the firm;

    (c) Be satisfied that the nature and scope of, and conclusions resulting from, such consultations are agreed with the party consulted; and

    (d) Determine that conclusions resulting from such consultations have been implemented. (Ref: Para. A22-A23)

Engagement Quality Control Review

19. For audits of financial statements of listed entities, and those other audit engagements, if any, for which the firm has determined that an engagement quality control review is required, the engagement partner shall:

    (a) Determine that an engagement quality control reviewer has been appointed;

    (b) Discuss significant matters arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer; and

    (c) Not date the auditor's report until the completion of the engagement quality control review. (Ref: Para. A24-A26)

20. The engagement quality control reviewer shall perform an objective evaluation of the significant judgments made by the engagement team, and the conclusions reached in formulating the auditor's report. This evaluation shall involve:

    (a) Discussion of significant matters with the engagement partner;

    (b) Review of the financial statements and the proposed auditor's report;

    (c) Review of selected audit documentation relating to the significant judgments the engagement team made and the conclusions it reached; and

    (d) Evaluation of the conclusions reached in formulating the auditor's report and consideration of whether the proposed auditor's report is appropriate. (Ref: Para. A27-A29, A31-A33)

21. For audits of financial statements of listed entities, the engagement quality control reviewer, on performing an engagement quality control review, shall also consider the following:

    (a) The engagement team's evaluation of the firm's independence in relation to the audit engagement;

(b) Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations; and

(c) Whether audit documentation selected for review reflects the work performed in relation to the significant judgments and supports the conclusions reached. (Ref: Para. A30-A33)

Differences of Opinion

22. If differences of opinion arise within the engagement team, with those consulted or, where applicable, between the engagement partner and the engagement quality control reviewer, the engagement team shall follow the firm's policies and procedures for dealing with and resolving differences of opinion.

Monitoring

23. An effective system of quality control includes a monitoring process designed to provide the firm with reasonable assurance that its policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively. The engagement partner shall consider the results of the firm's monitoring process as evidenced in the latest information circulated by the firm and, if applicable, other network firms and whether deficiencies noted in that information may affect the audit engagement. (Ref: Para A34-A36)

Documentation

24. The auditor shall include in the audit documentation: [5]

(a) Issues identified with respect to compliance with relevant ethical requirements and how they were resolved.

(b) Conclusions on compliance with independence requirements that apply to the audit engagement, and any relevant discussions with the firm that support these conclusions.

(c) Conclusions reached regarding the acceptance and continuance of client relationships and audit engagements.

(d) The nature and scope of, and conclusions resulting from, consultations undertaken during the course of the audit engagement. (Ref: Para. A37)

25. The engagement quality control reviewer shall document, for the audit engagement reviewed, that:

(a) The procedures required by the firm's policies on engagement quality control review have been performed;

(b) The engagement quality control review has been completed on or before the date of the auditor's report; and

(c) The reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions it reached were not appropriate.

[5] HKSA 230, *Audit Documentation*, paragraphs 8-11, and A6

Conformity and Compliance with International Standards on Auditing

26. As of June 2009 (date of issue), this HKSA conforms with International Standard on Auditing (ISA) 220, *Quality Control for an Audit of Financial Statements*. Compliance with the requirements of this HKSA ensures compliance with ISA 220.

***

Application and Other Explanatory Material

System of Quality Control and Role of Engagement Teams (Ref: Para. 2)

A1. HKSQC 1 deals with the firm's responsibilities to establish and maintain its system of quality control for audit engagements. The system of quality control includes policies and procedures that address each of the following elements:

- Leadership responsibilities for quality within the firm;
- Relevant ethical requirements;
- Acceptance and continuance of client relationships and specific engagements;
- Human resources;
- Engagement performance; and
- Monitoring.

HKSQC 1 contains requirements which are at least as demanding as its international equivalent, ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*[*], as it addresses all the elements referred to in ISQC 1 and imposes obligations on the firm that achieve the aims of the requirements set out in ISQC 1.

Reliance on the Firm's System of Quality Control (Ref: Para. 4)

A2. Unless information provided by the firm or other parties suggest otherwise, the engagement team may rely on the firm's system of quality control in relation to, for example:

- 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.
- Adherence to applicable legal and regulatory requirements through the monitoring process.

[*] Issued by the International Auditing and Assurance Standards Board.

Leadership Responsibilities for Quality on Audits (Ref: Para. 8)

A3. The actions of the engagement partner and appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality on each audit engagement, emphasize:

(a) The importance to audit quality of:

(i) Performing work that complies with professional standards and applicable legal and regulatory requirements;

(ii) Complying with the firm's quality control policies and procedures as applicable;

(iii) Issuing auditor's reports that are appropriate in the circumstances; and

(iv) The engagement team's ability to raise concerns without fear of reprisals; and

(b) The fact that quality is essential in performing audit engagements.

Relevant Ethical Requirements

Compliance with Relevant Ethical Requirements (Ref: Para. 9)

A4. The Code establishes the fundamental principles of professional ethics, which include:

(a) Integrity;

(b) Objectivity;

(c) Professional competence and due care;

(d) Confidentiality; and

(e) Professional behavior.

Definition of "Firm," "Network" and "Network Firm" (Ref: Para. 9-11)

A5. The definitions of "firm," "network" or "network firm" in relevant ethical requirements may differ from those set out in this HKSA. For example, the Code defines the "firm" as:

(a) A sole practitioner, partnership or corporation of professional accountants;

(b) An entity that controls such parties through ownership, management or other means; and

(c) An entity controlled by such parties through ownership, management or other means.

The Code also provides guidance in relation to the terms "network" and "network firm."

In complying with the requirements in paragraphs 9-11, the definitions used in the relevant ethical requirements apply in so far as is necessary to interpret those ethical requirements.

Threats to Independence (Ref: Para. 11(c))

A6. The engagement partner may identify a threat to independence regarding the audit engagement that safeguards may not be able to eliminate or reduce to an acceptable level. In that case, as required by paragraph 11(c), the engagement partner reports to the relevant person(s) within the firm to determine appropriate action, which may include eliminating the activity or interest that creates the threat, or withdrawing from the audit engagement, where withdrawal is possible under applicable law or regulation.

Considerations Specific to Public Sector Entities

A7. Statutory measures may provide safeguards for the independence of public sector auditors. However, public sector auditors or audit firms carrying out public sector audits on behalf of the statutory auditor may, depending on the terms of the mandate in a particular jurisdiction, need to adapt their approach in order to promote compliance with the spirit of paragraph 11. This may include, where the public sector auditor's mandate does not permit withdrawal from the engagement, disclosure through a public report, of circumstances that have arisen that would, if they were in the private sector, lead the auditor to withdraw.

Acceptance and Continuance of Client Relationships and Audit Engagements (Ref: Para. 12)

A8. HKSQC 1 requires the firm to obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client.[6] Information such as the following assists the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate:

- The integrity of the principal owners, key management and those charged with governance of the entity;
- Whether the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources;
- Whether the firm and the engagement team can comply with relevant ethical requirements; and
- Significant matters that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.

A9. Law, regulation, or relevant ethical requirements[7] may require the auditor to request, prior to accepting the engagement, the predecessor auditor to provide known information regarding any facts or circumstances that, in the predecessor auditor's judgment, the auditor needs to be aware of before deciding whether to accept the engagement. In some circumstances, the predecessor auditor may be required, on request by the proposed successor auditor, to provide information regarding identified or suspected non-compliance with laws and regulations to the proposed successor auditor. For example, where the predecessor auditor has withdrawn from the engagement as a result of identified or suspected non-compliance with laws and regulations, the Code requires that the predecessor auditor, on request by a proposed successor auditor, provides all such facts and other information concerning such non-compliance that, in the predecessor auditor's opinion, the proposed successor auditor needs to be aware of before deciding whether to accept the audit appointment.[8]

6 HKSQC 1, paragraph 27(a)
7 See, for example, Section 210.14 of the Code.
8 See, for example, Section 225.31 of the Code.

Considerations Specific to Public Sector Entities (Ref: Para. 12-13)

A10. In the public sector, auditors may be appointed in accordance with statutory procedures. Accordingly, certain of the requirements and considerations regarding the acceptance and continuance of client relationships and audit engagements as set out in paragraphs 12, 13 and A8 may not be relevant. Nonetheless, information gathered as a result of the process described may be valuable to public sector auditors in performing risk assessments and in carrying out reporting responsibilities.

Assignment of Engagement Teams (Ref: Para. 14)

A11. An engagement team includes a person using expertise in a specialized area of accounting or auditing, whether engaged or employed by the firm, if any, who performs audit procedures on the engagement. However, a person with such expertise is not a member of the engagement team if that person's involvement with the engagement is only consultation. Consultations are addressed in paragraphs 18, A22 and A23.

A12. When considering the appropriate competence and capabilities expected of the engagement team as a whole, the engagement partner may take into consideration such matters as the team's:

- Understanding of, and practical experience with, audit engagements of a similar nature and complexity through appropriate training and participation.
- Understanding of professional standards and applicable legal and regulatory requirements.
- Technical expertise, including expertise with relevant information technology and specialized areas of accounting or auditing.
- Knowledge of relevant industries in which the client operates.
- Ability to apply professional judgment.
- Understanding of the firm's quality control policies and procedures.

Considerations Specific to Public Sector Entities

A13. In the public sector, additional appropriate competence may include skills that are necessary to discharge the terms of the audit mandate in a particular jurisdiction. Such competence may include an understanding of the applicable reporting arrangements, including reporting to the legislature or other governing body or in the public interest. The wider scope of a public sector audit may include, for example, some aspects of performance auditing or a comprehensive assessment of compliance with law, regulation or other authority and preventing and detecting fraud and corruption.

Engagement Performance

Direction, Supervision and Performance (Ref: Para. 15(a))

A14. Direction of the engagement team involves informing the members of the engagement team of matters such as:

- Their responsibilities, including the need to comply with relevant ethical requirements, and to plan and perform an audit with professional skepticism as required by HKSA 200.[9]

- Responsibilities of respective partners where more than one partner is involved in the conduct of an audit engagement.
- The objectives of the work to be performed.
- The nature of the entity's business.
- Risk-related issues.
- Problems that may arise.
- The detailed approach to the performance of the engagement.

Discussion among members of the engagement team allows less experienced team members to raise questions with more experienced team members so that appropriate communication can occur within the engagement team.

A15. Appropriate teamwork and training assist less experienced members of the engagement team to clearly understand the objectives of the assigned work.

A16. Supervision includes matters such as:

- Tracking the progress of the audit engagement.
- Considering the competence and capabilities of individual members of the engagement team, including whether they have sufficient time to carry out their work, whether they understand their instructions and whether the work is being carried out in accordance with the planned approach to the audit engagement.
- Addressing significant matters arising during the audit engagement, considering their significance and modifying the planned approach appropriately.
- Identifying matters for consultation or consideration by more experienced engagement team members during the audit engagement.

Reviews

Review Responsibilities (Ref: Para. 16)

A17. Under HKSQC 1, the firm's review responsibility policies and procedures are determined on the basis that work of less experienced team members is reviewed by more experienced team members.[10]

A18. A review consists of consideration whether, for example:

- The work has been performed in accordance with professional standards and applicable legal and regulatory requirements;
- Significant matters have been raised for further consideration;

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[9] HKSA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing*, paragraph 15

[10] HKSQC 1, paragraph 33

- Appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- There is a need to revise the nature, timing and extent of work performed;
- The work performed supports the conclusions reached and is appropriately documented;
- The evidence obtained is sufficient and appropriate to support the auditor's report; and
- The objectives of the engagement procedures have been achieved.

The Engagement Partner's Review of Work Performed (Ref: Para. 17)

A19. Timely reviews of the following by the engagement partner at appropriate stages during the engagement allow significant matters to be resolved on a timely basis to the engagement partner's satisfaction on or before the date of the auditor's report:

- Critical areas of judgment, especially those relating to difficult or contentious matters identified during the course of the engagement;
- Significant risks; and
- Other areas the engagement partner considers important.

The engagement partner need not review all audit documentation, but may do so. However, as required by HKSA 230, the partner documents the extent and timing of the reviews.[11]

A20. An engagement partner taking over an audit during the engagement may apply the review procedures as described in paragraph A18 to review the work performed to the date of a change in order to assume the responsibilities of an engagement partner.

Considerations Relevant Where a Member of the Engagement Team with Expertise in a Specialized Area of Accounting or Auditing Is Used (Ref: Para. 15-17)

A21. Where a member of the engagement team with expertise in a specialized area of accounting or auditing is used, direction, supervision and review of that engagement team member's work may include matters such as:

- Agreeing with that member the nature, scope and objectives of that member's work; and the respective roles of, and the nature, timing and extent of communication between that member and other members of the engagement team.
- Evaluating the adequacy of that member's work including the relevance and reasonableness of that member's findings or conclusions and their consistency with other audit evidence.

Consultation (Ref: Para. 18)

A22. Effective consultation on significant technical, ethical and other matters within the firm or, where applicable, outside the firm can be achieved when those consulted:

- Are given all the relevant facts that will enable them to provide informed advice; and
- Have appropriate knowledge, seniority and experience.

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[11] HKSA 230, paragraph 9(c)

A23. It may be appropriate for the engagement team to consult outside the firm, for example, where the firm lacks appropriate internal resources. They may take advantage of advisory services provided by other firms, professional and regulatory bodies, or commercial organizations that provide relevant quality control services.

Engagement Quality Control Review

Completion of the Engagement Quality Control Review before Dating of the Auditor's Report (Ref: Para. 19(c))

A24. HKSA 700 (Revised) requires the auditor's report to be dated no earlier than the date on which the auditor has obtained sufficient appropriate evidence on which to base the auditor's opinion on the financial statements.[12] In cases of an audit of financial statements of listed entities or when an engagement meets the criteria for an engagement quality control review, such a review assists the auditor in determining whether sufficient appropriate evidence has been obtained.

A25. Conducting the engagement quality control review in a timely manner at appropriate stages during the engagement allows significant matters to be promptly resolved to the engagement quality control reviewer's satisfaction on or before the date of the auditor's report.

A26. Completion of the engagement quality control review means the completion by the engagement quality control reviewer of the requirements in paragraphs 20-21, and where applicable, compliance with paragraph 22. Documentation of the engagement quality control review may be completed after the date of the auditor's report as part of the assembly of the final audit file. HKSA 230 establishes requirements and provides guidance in this regard.[13]

Nature, Timing and Extent of Engagement Quality Control Review (Ref: Para. 20)

A27. Remaining alert for changes in circumstances allows the engagement partner to identify situations in which an engagement quality control review is necessary, even though at the start of the engagement, such a review was not required.

A28. The extent of the engagement quality control review may depend, among other things, on the complexity of the audit engagement, whether the entity is a listed entity, and the risk that the auditor's report might not be appropriate in the circumstances. The performance of an engagement quality control review does not reduce the responsibilities of the engagement partner for the audit engagement and its performance.

A29. When HKSA 701[14] applies, the conclusions reached by the engagement team in formulating the auditor's report include determining:

- The key audit matters to be included in the auditor's report;
- The key audit matters that will not be communicated in the auditor's report in accordance with paragraph 14 of HKSA 701, if any; and
- If applicable, depending on the facts and circumstances of the entity and the audit, that there are no key audit matters to communicate in the auditor's report.

In addition, the review of the proposed auditor's report in accordance with paragraph 20(b) includes consideration of the proposed wording to be included in the Key Audit Matters section.

[12] HKSA 700 (Revised) , *Forming an Opinion and Reporting on Financial Statements*, paragraph 49

[13] HKSA 230, paragraphs 14-16

[14] HKSA 701, *Communicating Key Audit Matters in the Auditor's Report*

Engagement Quality Control Review of Listed Entities (Ref: Para. 21)

A30. Other matters relevant to evaluating the significant judgments made by the engagement team that may be considered in an engagement quality control review of a listed entity include:

- Significant risks identified during the engagement in accordance with HKSA 315 (Revised),[15] and the responses to those risks in accordance with HKSA 330,[16] including the engagement team's assessment of, and response to, the risk of fraud in accordance with HKSA 240.[17]

- Judgments made, particularly with respect to materiality and significant risks.

- The significance and disposition of corrected and uncorrected misstatements identified during the audit.

- The matters to be communicated to management and those charged with governance and, where applicable, other parties such as regulatory bodies.

These other matters, depending on the circumstances, may also be applicable for engagement quality control reviews for audits of financial statements of other entities.

Considerations Specific to Smaller Entities (Ref: Para. 20-21)

A31. In addition to the audits of financial statements of listed entities, an engagement quality control review is required for audit engagements that meet the criteria established by the firm that subjects engagements to an engagement quality control review. In some cases, none of the firm's audit engagements may meet the criteria that would subject them to such a review.

Considerations Specific to Public Sector Entities (Ref: Para. 20-21)

A32. In the public sector, a statutorily appointed auditor (for example, an Auditor General, or other suitably qualified person appointed on behalf of the Auditor General), may act in a role equivalent to that of engagement partner with overall responsibility for public sector audits. In such circumstances, where applicable, the selection of the engagement quality control reviewer includes consideration of the need for independence from the audited entity and the ability of the engagement quality control reviewer to provide an objective evaluation.

A33. Listed entities as referred to in paragraphs 21 and A29 are not common in the public sector. However, there may be other public sector entities that are significant due to size, complexity or public interest aspects, and which consequently have a wide range of stakeholders. Examples include state owned corporations and public utilities. Ongoing transformations within the public sector may also give rise to new types of significant entities. There are no fixed objective criteria on which the determination of significance is based. Nonetheless, public sector auditors evaluate which entities may be of sufficient significance to warrant performance of an engagement quality control review.

[15] HKSA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

[16] HKSA 330, *The Auditor's Responses to Assessed Risks*

[17] HKSA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

Monitoring (Ref: Para. 23)

A34. HKSQC 1 requires the firm to establish a monitoring process designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate and operating effectively.[18]

A35. In considering deficiencies that may affect the audit engagement, the engagement partner may have regard to measures the firm took to rectify the situation that the engagement partner considers are sufficient in the context of that audit.

A36. A deficiency in the firm's system of quality control does not necessarily indicate that a particular audit engagement was not performed in accordance with professional standards and applicable legal and regulatory requirements, or that the auditor's report was not appropriate.

Documentation

Documentation of Consultations (Ref: Para. 24(d))

A37. Documentation of consultations with other professionals that involve difficult or contentious matters that is sufficiently complete and detailed contributes to an understanding of:

- The issue on which consultation was sought; and
- The results of the consultation, including any decisions taken, the basis for those decisions and how they were implemented.

[18] HKSQC 1, paragraph 48

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

Hong Kong Standard on Auditing 240

The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

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

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HONG KONG STANDARD ON AUDITING 240

THE AUDITOR'S RESPONSIBILITIES RELATING TO FRAUD IN AN AUDIT OF FINANCIAL STATEMENTS

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

CONTENTS

CONTENTS

Hong Kong Standard on Auditing (HKSA) 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, 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 the auditor's responsibilities relating to fraud in an audit of financial statements. Specifically, it expands on how HKSA 315 (Revised)[1] and HKSA 330[2] are to be applied in relation to risks of material misstatement due to fraud.

Characteristics of Fraud

2. Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional.

3. Although fraud is a broad legal concept, for the purposes of the HKSAs, the auditor is concerned with fraud that causes a material misstatement in the financial statements. Two types of intentional misstatements are relevant to the auditor – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets. Although the auditor may suspect or, in rare cases, identify the occurrence of fraud, the auditor does not make legal determinations of whether fraud has actually occurred. (Ref: Para. A1-A7)

Responsibility for the Prevention and Detection of Fraud

4. The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. It is important that management, with the oversight of those charged with governance, place a strong emphasis on fraud prevention, which may reduce opportunities for fraud to take place, and fraud deterrence, which could persuade individuals not to commit fraud because of the likelihood of detection and punishment. This involves a commitment to creating a culture of honesty and ethical behavior which can be reinforced by an active oversight by those charged with governance. Oversight by those charged with governance includes considering the potential for override of controls or other inappropriate influence over the financial reporting process, such as efforts by management to manage earnings in order to influence the perceptions of analysts as to the entity's performance and profitability.

Responsibilities of the Auditor

5. An auditor conducting an audit in accordance with HKSAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the HKSAs.[3]

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[1] HKSA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

[2] HKSA 330, *The Auditor's Responses to Assessed Risks*

[3] HKSA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing*, paragraphs A53-A54

6. As described in HKSA 200,[4] the potential effects of inherent limitations are particularly significant in the case of misstatement resulting from fraud. The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor. Such attempts at concealment may be even more difficult to detect when accompanied by collusion. Collusion may cause the auditor to believe that audit evidence is persuasive when it is, in fact, false. The auditor's ability to detect a fraud depends on factors such as the skillfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved. While the auditor may be able to identify potential opportunities for fraud to be perpetrated, it is difficult for the auditor to determine whether misstatements in judgment areas such as accounting estimates are caused by fraud or error.

7. Furthermore, the risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud, because management is frequently in a position to directly or indirectly manipulate accounting records, present fraudulent financial information or override control procedures designed to prevent similar frauds by other employees.

8. When obtaining reasonable assurance, the auditor is responsible for maintaining professional skepticism throughout the audit, considering the potential for management override of controls and recognizing the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud. The requirements in this HKSA are designed to assist the auditor in identifying and assessing the risks of material misstatement due to fraud and in designing procedures to detect such misstatement.

9. The auditor may have additional responsibilities under law, regulation or relevant ethical requirements regarding an entity's non-compliance with laws and regulations, including fraud, which may differ from or go beyond this and other HKSAs, such as: (Ref: Para. A6)

    (a) Responding to identified or suspected non-compliance with laws and regulations, including requirements in relation to specific communications with management and those charged with governance, assessing the appropriateness of their response to non-compliance and determining whether further action is needed;

    (b) Communicating identified or suspected non-compliance with laws and regulations to other auditors (e.g., in an audit of group financial statements); and

    (c) Documentation requirements regarding identified or suspected non-compliance with laws and regulations.

    Complying with any additional responsibilities may provide further information that is relevant to the auditor's work in accordance with this and other HKSAs (e.g., regarding the integrity of management or, where appropriate, those charged with governance).

Effective Date

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

[4] HKSA 200, paragraph A53

Objectives

11. The objectives of the auditor are:

    (a) To identify and assess the risks of material misstatement of the financial statements due to fraud;

    (b) To obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and

    (c) To respond appropriately to fraud or suspected fraud identified during the audit.

Definitions

12. For purposes of the HKSAs, the following terms have the meanings attributed below:

    (a) Fraud – An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.

    (b) Fraud risk factors – Events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud.

Requirements

Professional Skepticism

13. In accordance with HKSA 200[5], the auditor shall maintain professional skepticism throughout the audit, recognizing the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and those charged with governance. (Ref: Para. A8- A9)

14. Unless the auditor has reason to believe the contrary, the auditor may accept records and documents as genuine. If conditions identified during the audit cause the auditor to believe that a document may not be authentic or that terms in a document have been modified but not disclosed to the auditor, the auditor shall investigate further. (Ref: Para. A10)

15. Where responses to inquiries of management or those charged with governance are inconsistent, the auditor shall investigate the inconsistencies.

Discussion among the Engagement Team

16. HKSA 315 (Revised) requires a discussion among the engagement team members and a determination by the engagement partner of which matters are to be communicated to those team members not involved in the discussion.[6] This discussion shall place particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud might occur. The discussion shall occur setting aside beliefs that the engagement team members may have that management and those charged with governance are honest and have integrity. (Ref: Para. A11-A12)

[5] HKSA 200, paragraph 15

[6] HKSA 315 (Revised), paragraph 10

Risk Assessment Procedures and Related Activities

17. When performing risk assessment procedures and related activities to obtain an understanding of the entity and its environment, including the entity's internal control, required by HKSA 315 (Revised),[7] the auditor shall perform the procedures in paragraphs 18-25 to obtain information for use in identifying the risks of material misstatement due to fraud.

Management and Others within the Entity

18. The auditor shall make inquiries of management regarding:

    (a) Management's assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments; (Ref: Para. A13-A14)

    (b) Management's process for identifying and responding to the risks of fraud in the entity, including any specific risks of fraud that management has identified or that have been brought to its attention, or classes of transactions, account balances, or disclosures for which a risk of fraud is likely to exist; (Ref: Para. A15)

    (c) Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity; and

    (d) Management's communication, if any, to employees regarding its views on business practices and ethical behavior.

19. The auditor shall make inquiries of management, and others within the entity as appropriate, to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity. (Ref: Para. A16-A18)

20. For those entities that have an internal audit function, the auditor shall make inquiries of appropriate individuals within the function to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its views about the risks of fraud. (Ref: Para. A19)

Those Charged with Governance

21. Unless all of those charged with governance are involved in managing the entity,[8] the auditor shall obtain an understanding of how those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks. (Ref: Para. A20-A22)

22. Unless all of those charged with governance are involved in managing the entity, the auditor shall make inquiries of those charged with governance to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity. These inquiries are made in part to corroborate the responses to the inquiries of management.

Unusual or Unexpected Relationships Identified

23. The auditor shall evaluate whether unusual or unexpected relationships that have been identified in performing analytical procedures, including those related to revenue accounts, may indicate risks of material misstatement due to fraud.

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7 HKSA 315 (Revised), paragraphs 5-24

8 HKSA 260 (Revised), *Communication with Those Charged with Governance*, paragraph 13

Other Information

24. The auditor shall consider whether other information obtained by the auditor indicates risks of material misstatement due to fraud. (Ref: Para. A23)

Evaluation of Fraud Risk Factors

25. The auditor shall evaluate whether the information obtained from the other risk assessment procedures and related activities performed indicates that one or more fraud risk factors are present. While fraud risk factors may not necessarily indicate the existence of fraud, they have often been present in circumstances where frauds have occurred and therefore may indicate risks of material misstatement due to fraud. (Ref: Para. A24-A28)

Identification and Assessment of the Risks of Material Misstatement Due to Fraud

26. In accordance with HKSA 315 (Revised), the auditor shall identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures.[9]

27. When identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks. Paragraph 48 specifies the documentation required where the auditor concludes that the presumption is not applicable in the circumstances of the engagement and, accordingly, has not identified revenue recognition as a risk of material misstatement due to fraud. (Ref: Para. A29-A31)

28. The auditor shall treat those assessed risks of material misstatement due to fraud as significant risks and accordingly, to the extent not already done so, the auditor shall obtain an understanding of the entity's related controls, including control activities, relevant to such risks. (Ref: Para. A32-A33)

Responses to the Assessed Risks of Material Misstatement Due to Fraud

Overall Responses

29. In accordance with HKSA 330, the auditor shall determine overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level.[10] (Ref: Para. A34)

30. In determining overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level, the auditor shall:

    (a) Assign and supervise personnel taking account of the knowledge, skill and ability of the individuals to be given significant engagement responsibilities and the auditor's assessment of the risks of material misstatement due to fraud for the engagement; (Ref: Para. A35-A36)

    (b) Evaluate whether the selection and application of accounting policies by the entity, particularly those related to subjective measurements and complex transactions, may be indicative of fraudulent financial reporting resulting from management's effort to manage earnings; and

    (c) Incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures. (Ref: Para. A37)

[9] HKSA 315 (Revised), paragraph 25

[10] HKSA 330, paragraph 5

Audit Procedures Responsive to Assessed Risks of Material Misstatement Due to Fraud at the Assertion Level

31. In accordance with HKSA 330, the auditor shall design and perform further audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement due to fraud at the assertion level.[11] (Ref: Para. A38-A41)

Audit Procedures Responsive to Risks Related to Management Override of Controls

32. Management is in a unique position to perpetrate fraud because of management's ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Although the level of risk of management override of controls will vary from entity to entity, the risk is nevertheless present in all entities. Due to the unpredictable way in which such override could occur, it is a risk of material misstatement due to fraud and thus a significant risk.

33. Irrespective of the auditor's assessment of the risks of management override of controls, the auditor shall design and perform audit procedures to:

    (a) Test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements. In designing and performing audit procedures for such tests, the auditor shall:

        (i) Make inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments;

        (ii) Select journal entries and other adjustments made at the end of a reporting period; and

        (iii) Consider the need to test journal entries and other adjustments throughout the period. (Ref: Para. A42-A45)

    (b) Review accounting estimates for biases and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud. In performing this review, the auditor shall:

        (i) Evaluate whether the judgments and decisions made by management in making the accounting estimates included in the financial statements, even if they are individually reasonable, indicate a possible bias on the part of the entity's management that may represent a risk of material misstatement due to fraud. If so, the auditor shall reevaluate the accounting estimates taken as a whole; and

        (ii) Perform a retrospective review of management judgments and assumptions related to significant accounting estimates reflected in the financial statements of the prior year. (Ref: Para. A46-A48)

    (c) For significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual given the auditor's understanding of the entity and its environment and other information obtained during the audit, the auditor shall evaluate whether the business rationale (or the lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets. (Ref: Para. A49)

[11] HKSA 330, paragraph 6

34. The auditor shall determine whether, in order to respond to the identified risks of management override of controls, the auditor needs to perform other audit procedures in addition to those specifically referred to above (that is, where there are specific additional risks of management override that are not covered as part of the procedures performed to address the requirements in paragraph 33).

Evaluation of Audit Evidence (Ref: Para. A50)

35. The auditor shall evaluate whether analytical procedures that are performed near the end of the audit, when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity, indicate a previously unrecognized risk of material misstatement due to fraud. (Ref: Para. A51)

36. If the auditor identifies a misstatement, the auditor shall evaluate whether such a misstatement is indicative of fraud. If there is such an indication, the auditor shall evaluate the implications of the misstatement in relation to other aspects of the audit, particularly the reliability of management representations, recognizing that an instance of fraud is unlikely to be an isolated occurrence. (Ref: Para. A52)

37. If the auditor identifies a misstatement, whether material or not, and the auditor has reason to believe that it is or may be the result of fraud and that management (in particular, senior management) is involved, the auditor shall reevaluate the assessment of the risks of material misstatement due to fraud and its resulting impact on the nature, timing and extent of audit procedures to respond to the assessed risks. The auditor shall also consider whether circumstances or conditions indicate possible collusion involving employees, management or third parties when reconsidering the reliability of evidence previously obtained. (Ref: Para. A53)

38. If the auditor confirms that, or is unable to conclude whether, the financial statements are materially misstated as a result of fraud the auditor shall evaluate the implications for the audit. (Ref: Para. A54)

Auditor Unable to Continue the Engagement

39. If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall:

    (a) Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;

    (b) Consider whether it is appropriate to withdraw from the engagement, where withdrawal is possible under applicable law or regulation; and

    (c) If the auditor withdraws:

        (i) Discuss with the appropriate level of management and those charged with governance the auditor's withdrawal from the engagement and the reasons for the withdrawal; and

        (ii) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal. (Ref: Para. A55-A58)

Written Representations

40. The auditor shall obtain written representations from management and, where appropriate, those charged with governance that:

    (a) They acknowledge their responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud;

    (b) They have disclosed to the auditor the results of management's assessment of the risk that the financial statements may be materially misstated as a result of fraud;

    (c) They have disclosed to the auditor their knowledge of fraud, or suspected fraud, affecting the entity involving:

        (i) Management;

        (ii) Employees who have significant roles in internal control; or

        (iii) Others where the fraud could have a material effect on the financial statements; and

    (d) They have disclosed to the auditor their knowledge of any allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others. (Ref: Para. A59-A60)

Communications to Management and with Those Charged with Governance

41. If the auditor has identified a fraud or has obtained information that indicates that a fraud may exist, the auditor shall communicate these matters, unless prohibited by law or regulation, on a timely basis with the appropriate level of management in order to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities. (Ref: Para. A61–A62)

42. Unless all of those charged with governance are involved in managing the entity, if the auditor has identified or suspects fraud involving:

    (a) management;

    (b) employees who have significant roles in internal control; or

    (c) others where the fraud results in a material misstatement in the financial statements,

    the auditor shall communicate these matters with those charged with governance on a timely basis. If the auditor suspects fraud involving management, the auditor shall communicate these suspicions with those charged with governance and discuss with them the nature, timing and extent of audit procedures necessary to complete the audit. Such communications with those charged with governance are required unless the communication is prohibited by law or regulation. (Ref: Para. A61, A63-A65)

43. The auditor shall communicate, unless prohibited by law or regulation, with those charged with governance any other matters related to fraud that are, in the auditor's judgment, relevant to their responsibilities. (Ref: Para. A61, A66)

Reporting Fraud to an Appropriate Authority Outside the Entity [11a]

44. If the auditor has identified or suspects a fraud, the auditor shall determine whether law, regulation or relevant ethical requirements: (Ref: Para. A67-A69)

    (a) Require the auditor to report to an appropriate authority outside the entity.

    (b) Establish responsibilities under which reporting to an appropriate authority outside the entity may be appropriate in the circumstances.

Documentation

45. The auditor shall include the following in the audit documentation [12] of the auditor's understanding of the entity and its environment and the assessment of the risks of material misstatement required by HKSA 315 (Revised):[13]

    (a) The significant decisions reached during the discussion among the engagement team regarding the susceptibility of the entity's financial statements to material misstatement due to fraud; and

    (b) The identified and assessed risks of material misstatement due to fraud at the financial statement level and at the assertion level.

46. The auditor shall include the following in the audit documentation of the auditor's responses to the assessed risks of material misstatement required by HKSA 330:[14]

    (a) The overall responses to the assessed risks of material misstatement due to fraud at the financial statement level and the nature, timing and extent of audit procedures, and the linkage of those procedures with the assessed risks of material misstatement due to fraud at the assertion level; and

    (b) The results of the audit procedures, including those designed to address the risk of management override of controls.

47. The auditor shall include in the audit documentation communications about fraud made to management, those charged with governance, regulators and others.

48. If the auditor has concluded that the presumption that there is a risk of material misstatement due to fraud related to revenue recognition is not applicable in the circumstances of the engagement, the auditor shall include in the audit documentation the reasons for that conclusion.

Conformity and Compliance with International Standards on Auditing

49. As of July 2009 (date of issue), this HKSA conforms with International Standard on Auditing (ISA) 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*. Compliance with the requirements of this HKSA ensures compliance with ISA 240.

50. Additional local explanation is provided in footnote 11a, 25a and local guidance is provided in Appendix 4.

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[11a] Additional local guidance is provided in Appendix 4.

[12] HKSA 230, *Audit Documentation*, paragraphs 8-11, and paragraph A6

[13] HKSA 315 (Revised), paragraph 32

[14] HKSA 330, paragraph 28

Application and Other Explanatory Material

Characteristics of Fraud (Ref: Para. 3)

A1. Fraud, whether fraudulent financial reporting or misappropriation of assets, involves incentive or pressure to commit fraud, a perceived opportunity to do so and some rationalization of the act. For example:

- Incentive or pressure to commit fraudulent financial reporting may exist when management is under pressure, from sources outside or inside the entity, to achieve an expected (and perhaps unrealistic) earnings target or financial outcome – particularly since the consequences to management for failing to meet financial goals can be significant. Similarly, individuals may have an incentive to misappropriate assets, for example, because the individuals are living beyond their means.

- A perceived opportunity to commit fraud may exist when an individual believes internal control can be overridden, for example, because the individual is in a position of trust or has knowledge of specific deficiencies in internal control.

- Individuals may be able to rationalize committing a fraudulent act. Some individuals possess an attitude, character or set of ethical values that allow them knowingly and intentionally to commit a dishonest act. However, even otherwise honest individuals can commit fraud in an environment that imposes sufficient pressure on them.

A2. Fraudulent financial reporting involves intentional misstatements including omissions of amounts or disclosures in financial statements to deceive financial statement users. It can be caused by the efforts of management to manage earnings in order to deceive financial statement users by influencing their perceptions as to the entity's performance and profitability. Such earnings management may start out with small actions or inappropriate adjustment of assumptions and changes in judgments by management. Pressures and incentives may lead these actions to increase to the extent that they result in fraudulent financial reporting. Such a situation could occur when, due to pressures to meet market expectations or a desire to maximize compensation based on performance, management intentionally takes positions that lead to fraudulent financial reporting by materially misstating the financial statements. In some entities, management may be motivated to reduce earnings by a material amount to minimize tax or to inflate earnings to secure bank financing.

A3. Fraudulent financial reporting may be accomplished by the following:

- Manipulation, falsification (including forgery), or alteration of accounting records or supporting documentation from which the financial statements are prepared.

- Misrepresentation in, or intentional omission from, the financial statements of events, transactions or other significant information.

- Intentional misapplication of accounting principles relating to amounts, classification, manner of presentation, or disclosure.

A4. Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls using such techniques as intentionally:

- Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.

- Inappropriately adjusting assumptions and changing judgments used to estimate account balances.

- Omitting, advancing or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period.

- Omitting, obscuring or misstating disclosures required by the applicable financial reporting framework, or disclosures that are necessary to achieve fair presentation.

- Concealing facts that could affect the amounts recorded in the financial statements.

- Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.

- Altering records and terms related to significant and unusual transactions.

A5. Misappropriation of assets involves the theft of an entity's assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it can also involve management who are usually more able to disguise or conceal misappropriations in ways that are difficult to detect. Misappropriation of assets can be accomplished in a variety of ways including:

- Embezzling receipts (for example, misappropriating collections on accounts receivable or diverting receipts in respect of written-off accounts to personal bank accounts).

- Stealing physical assets or intellectual property (for example, stealing inventory for personal use or for sale, stealing scrap for resale, colluding with a competitor by disclosing technological data in return for payment).

- Causing an entity to pay for goods and services not received (for example, payments to fictitious vendors, kickbacks paid by vendors to the entity's purchasing agents in return for inflating prices, payments to fictitious employees).

- Using an entity's assets for personal use (for example, using the entity's assets as collateral for a personal loan or a loan to a related party).

Misappropriation of assets is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorization.

Responsibility for the Prevention and Detection of Fraud

Responsibilities of the Auditor (Ref: Para. 9)

A6. Law, regulation or relevant ethical requirements may require the auditor to perform additional procedures and take further actions. For example, the HKICPA's *Code of Ethics for Professional Accountants* (the Code) requires the auditor to take steps to respond to identified or suspected non-compliance with laws and regulations and determine whether further action is needed. Such steps may include the communication of identified or suspected non-compliance with laws and regulations to other auditors within a group, including a group engagement partner, component auditors or other auditors performing work at components of a group for purposes other than the audit of the group financial statements.[15]

Considerations Specific to Public Sector Entities

A7. The public sector auditor's responsibilities relating to fraud may be a result of law, regulation or other authority applicable to public sector entities or separately covered by the auditor's mandate. Consequently, the public sector auditor's responsibilities may not be limited to consideration of risks of material misstatement of the financial statements, but may also include a broader responsibility to consider risks of fraud.

[15] See, for example, Sections 225.21–225.22 of the Code.

Professional Skepticism (Ref: Para. 13-15)

A8. Maintaining professional skepticism requires an ongoing questioning of whether the information and audit evidence obtained suggests that a material misstatement due to fraud may exist. It includes considering the reliability of the information to be used as audit evidence and the controls over its preparation and maintenance where relevant. Due to the characteristics of fraud, the auditor's professional skepticism is particularly important when considering the risks of material misstatement due to fraud.

A9. Although the auditor cannot be expected to disregard past experience of the honesty and integrity of the entity's management and those charged with governance, the auditor's professional skepticism is particularly important in considering the risks of material misstatement due to fraud because there may have been changes in circumstances.

A10. An audit performed in accordance with HKSAs rarely involves the authentication of documents, nor is the auditor trained as or expected to be an expert in such authentication.[16] However, when the auditor identifies conditions that cause the auditor to believe that a document may not be authentic or that terms in a document have been modified but not disclosed to the auditor, possible procedures to investigate further may include:

- Confirming directly with the third party.
- Using the work of an expert to assess the document's authenticity.

Discussion among the Engagement Team (Ref: Para. 16)

A11. Discussing the susceptibility of the entity's financial statements to material misstatement due to fraud with the engagement team:

- Provides an opportunity for more experienced engagement team members to share their insights about how and where the financial statements may be susceptible to material misstatement due to fraud.
- Enables the auditor to consider an appropriate response to such susceptibility and to determine which members of the engagement team will conduct certain audit procedures.
- Permits the auditor to determine how the results of audit procedures will be shared among the engagement team and how to deal with any allegations of fraud that may come to the auditor's attention.

A12. The discussion may include such matters as:

- An exchange of ideas among engagement team members about how and where they believe the entity's financial statements (including the individual statements and the disclosures) may be susceptible to material misstatement due to fraud, how management could perpetrate and conceal fraudulent financial reporting, and how assets of the entity could be misappropriated.
- A consideration of circumstances that might be indicative of earnings management and the practices that might be followed by management to manage earnings that could lead to fraudulent financial reporting.
- A consideration of the risk that management may attempt to present disclosures in a manner that may obscure a proper understanding of the matters disclosed (for

[16] HKSA 200, paragraph A49

example, by including too much immaterial information or by using unclear or ambiguous language).

- A consideration of the known external and internal factors affecting the entity that may create an incentive or pressure for management or others to commit fraud, provide the opportunity for fraud to be perpetrated, and indicate a culture or environment that enables management or others to rationalize committing fraud.
- A consideration of management's involvement in overseeing employees with access to cash or other assets susceptible to misappropriation.
- A consideration of any unusual or unexplained changes in behavior or lifestyle of management or employees which have come to the attention of the engagement team.
- An emphasis on the importance of maintaining a proper state of mind throughout the audit regarding the potential for material misstatement due to fraud.
- A consideration of the types of circumstances that, if encountered, might indicate the possibility of fraud.
- A consideration of how an element of unpredictability will be incorporated into the nature, timing and extent of the audit procedures to be performed.
- A consideration of the audit procedures that might be selected to respond to the susceptibility of the entity's financial statement to material misstatement due to fraud and whether certain types of audit procedures are more effective than others.
- A consideration of any allegations of fraud that have come to the auditor's attention.
- A consideration of the risk of management override of controls.

Risk Assessment Procedures and Related Activities

Inquiries of Management

Management's Assessment of the Risk of Material Misstatement Due to Fraud (Ref: Para. 18(a))

A13. Management accepts responsibility for the entity's internal control and for the preparation of the entity's financial statements. Accordingly, it is appropriate for the auditor to make inquiries of management regarding management's own assessment of the risk of fraud and the controls in place to prevent and detect it. The nature, extent and frequency of management's assessment of such risk and controls may vary from entity to entity. In some entities, management may make detailed assessments on an annual basis or as part of continuous monitoring. In other entities, management's assessment may be less structured and less frequent. The nature, extent and frequency of management's assessment are relevant to the auditor's understanding of the entity's control environment. For example, the fact that management has not made an assessment of the risk of fraud may in some circumstances be indicative of the lack of importance that management places on internal control.

Considerations specific to smaller entities

A14. In some entities, particularly smaller entities, the focus of management's assessment may be on the risks of employee fraud or misappropriation of assets.

Management's Process for Identifying and Responding to the Risks of Fraud (Ref: Para. 18(b))

A15. In the case of entities with multiple locations management's processes may include different levels of monitoring of operating locations, or business segments. Management may also have identified particular operating locations or business segments for which a risk of fraud may be more likely to exist.

Inquiry of Management and Others within the Entity (Ref: Para. 19)

A16. The auditor's inquiries of management may provide useful information concerning the risks of material misstatements in the financial statements resulting from employee fraud. However, such inquiries are unlikely to provide useful information regarding the risks of material misstatement in the financial statements resulting from management fraud. Making inquiries of others within the entity may provide individuals with an opportunity to convey information to the auditor that may not otherwise be communicated.

A17. Examples of others within the entity to whom the auditor may direct inquiries about the existence or suspicion of fraud include:

- Operating personnel not directly involved in the financial reporting process.
- Employees with different levels of authority.
- Employees involved in initiating, processing or recording complex or unusual transactions and those who supervise or monitor such employees.
- In-house legal counsel.
- Chief ethics officer or equivalent person.
- The person or persons charged with dealing with allegations of fraud.

A18. Management is often in the best position to perpetrate fraud. Accordingly, when evaluating management's responses to inquiries with an attitude of professional skepticism, the auditor may judge it necessary to corroborate responses to inquiries with other information.

Inquiries of Internal Audit (Ref: Para. 20)

A19. HKSA 315 (Revised) and HKSA 610 (Revised 2013) establish requirements and provide guidance relevant to audits of those entities that have an internal audit function.[17] In carrying out the requirements of those HKSAs in the context of fraud, the auditor may inquire about specific activities of the function including, for example:

- The procedures performed, if any, by the internal audit function during the year to detect fraud.
- Whether management has satisfactorily responded to any findings resulting from those procedures.

Obtaining an Understanding of Oversight Exercised by Those Charged with Governance (Ref: Para. 21)

A20. Those charged with governance of an entity oversee the entity's systems for monitoring risk, financial control and compliance with the law. In many countries, corporate governance practices are well developed and those charged with governance play an active role in oversight of the entity's assessment of the risks of fraud and of the relevant internal control. Since the responsibilities of those charged with governance and management may vary by entity and by country, it is important that the auditor understands their respective responsibilities to enable the auditor to obtain an understanding of the oversight exercised by the appropriate individuals.[18]

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[17] HKSA 315 (Revised), paragraphs 6(a) and 23, and HKSA 610 (Revised 2013), *Using the Work of Internal Auditors*

[18] HKSA 260 (Revised), paragraphs A1-A8, discuss with whom the auditor communicates when the entity's governance structure is not well defined.

A21. An understanding of the oversight exercised by those charged with governance may provide insights regarding the susceptibility of the entity to management fraud, the adequacy of internal control over risks of fraud, and the competency and integrity of management. The auditor may obtain this understanding in a number of ways, such as by attending meetings where such discussions take place, reading the minutes from such meetings or making inquiries of those charged with governance.

Considerations Specific to Smaller Entities

A22. In some cases, all of those charged with governance are involved in managing the entity. This may be the case in a small entity where a single owner manages the entity and no one else has a governance role. In these cases, there is ordinarily no action on the part of the auditor because there is no oversight separate from management.

Consideration of Other Information (Ref: Para. 24)

A23. In addition to information obtained from applying analytical procedures, other information obtained about the entity and its environment may be helpful in identifying the risks of material misstatement due to fraud. The discussion among team members may provide information that is helpful in identifying such risks. In addition, information obtained from the auditor's client acceptance and retention processes, and experience gained on other engagements performed for the entity, for example, engagements to review interim financial information, may be relevant in the identification of the risks of material misstatement due to fraud.

Evaluation of Fraud Risk Factors (Ref: Para. 25)

A24. The fact that fraud is usually concealed can make it very difficult to detect. Nevertheless, the auditor may identify events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud (fraud risk factors). For example:

- The need to meet expectations of third parties to obtain additional equity financing may create pressure to commit fraud;
- The granting of significant bonuses if unrealistic profit targets are met may create an incentive to commit fraud; and
- A control environment that is not effective may create an opportunity to commit fraud.

A25. Fraud risk factors cannot easily be ranked in order of importance. The significance of fraud risk factors varies widely. Some of these factors will be present in entities where the specific conditions do not present risks of material misstatement. Accordingly, the determination of whether a fraud risk factor is present and whether it is to be considered in assessing the risks of material misstatement of the financial statements due to fraud requires the exercise of professional judgment.

A26. Examples of fraud risk factors related to fraudulent financial reporting and misappropriation of assets are presented in Appendix 1. These illustrative risk factors are classified based on the three conditions that are generally present when fraud exists:

- An incentive or pressure to commit fraud;
- A perceived opportunity to commit fraud; and
- An ability to rationalize the fraudulent action.

Risk factors reflective of an attitude that permits rationalization of the fraudulent action may not be susceptible to observation by the auditor. Nevertheless, the auditor may become aware of the existence of such information. Although the fraud risk factors described in

Appendix 1 cover a broad range of situations that may be faced by auditors, they are only examples and other risk factors may exist.

A27. The size, complexity, and ownership characteristics of the entity have a significant influence on the consideration of relevant fraud risk factors. For example, in the case of a large entity, there may be factors that generally constrain improper conduct by management, such as:

- Effective oversight by those charged with governance.
- An effective internal audit function.
- The existence and enforcement of a written code of conduct.

Furthermore, fraud risk factors considered at a business segment operating level may provide different insights when compared with those obtained when considered at an entity-wide level.

Considerations Specific to Smaller Entities

A28. In the case of a small entity, some or all of these considerations may be inapplicable or less relevant. For example, a smaller entity may not have a written code of conduct but, instead, may have developed a culture that emphasizes the importance of integrity and ethical behavior through oral communication and by management example. Domination of management by a single individual in a small entity does not generally, in and of itself, indicate a failure by management to display and communicate an appropriate attitude regarding internal control and the financial reporting process. In some entities, the need for management authorization can compensate for otherwise deficient controls and reduce the risk of employee fraud. However, domination of management by a single individual can be a potential deficiency in internal control since there is an opportunity for management override of controls.

Identification and Assessment of the Risks of Material Misstatement Due to Fraud

Risks of Fraud in Revenue Recognition (Ref: Para. 27)

A29. Material misstatement due to fraudulent financial reporting relating to revenue recognition often results from an overstatement of revenues through, for example, premature revenue recognition or recording fictitious revenues. It may result also from an understatement of revenues through, for example, improperly shifting revenues to a later period.

A30. The risks of fraud in revenue recognition may be greater in some entities than others. For example, there may be pressures or incentives on management to commit fraudulent financial reporting through inappropriate revenue recognition in the case of listed entities when, for example, performance is measured in terms of year over year revenue growth or profit. Similarly, for example, there may be greater risks of fraud in revenue recognition in the case of entities that generate a substantial portion of revenues through cash sales.

A31. The presumption that there are risks of fraud in revenue recognition may be rebutted. For example, the auditor may conclude that there is no risk of material misstatement due to fraud relating to revenue recognition in the case where there is a single type of simple revenue transaction, for example, leasehold revenue from a single unit rental property.

Identifying and Assessing the Risks of Material Misstatement Due to Fraud and Understanding the Entity's Related Controls (Ref: Para. 28)

A32. Management may make judgments on the nature and extent of the controls it chooses to implement, and the nature and extent of the risks it chooses to assume.[19] In determining which controls to implement to prevent and detect fraud, management considers the risks that the financial statements may be materially misstated as a result of fraud. As part of this consideration, management may conclude that it is not cost effective to implement and maintain a particular control in relation to the reduction in the risks of material misstatement due to fraud to be achieved.

A33. It is therefore important for the auditor to obtain an understanding of the controls that management has designed, implemented and maintained to prevent and detect fraud. In doing so, the auditor may learn, for example, that management has consciously chosen to accept the risks associated with a lack of segregation of duties. Information from obtaining this understanding may also be useful in identifying fraud risks factors that may affect the auditor's assessment of the risks that the financial statements may contain material misstatement due to fraud.

Responses to the Assessed Risks of Material Misstatement Due to Fraud

Overall Responses (Ref: Para. 29)

A34. Determining overall responses to address the assessed risks of material misstatement due to fraud generally includes the consideration of how the overall conduct of the audit can reflect increased professional skepticism, for example, through:

- Increased sensitivity in the selection of the nature and extent of documentation to be examined in support of material transactions.
- Increased recognition of the need to corroborate management explanations or representations concerning material matters.

It also involves more general considerations apart from the specific procedures otherwise planned; these considerations include the matters listed in paragraph 30, which are discussed below.

Assignment and Supervision of Personnel (Ref: Para. 30(a))

A35. The auditor may respond to identified risks of material misstatement due to fraud by, for example, assigning additional individuals with specialized skill and knowledge, such as forensic and IT experts, or by assigning more experienced individuals to the engagement

A36. The extent of supervision reflects the auditor's assessment of risks of material misstatement due to fraud and the competencies of the engagement team members performing the work.

Unpredictability in the Selection of Audit Procedures (Ref: Para. 30(c))

A37. Incorporating an element of unpredictability in the selection of the nature, timing and extent of audit procedures to be performed is important as individuals within the entity who are familiar with the audit procedures normally performed on engagements may be more able to conceal fraudulent financial reporting. This can be achieved by, for example:

- Performing substantive procedures on selected account balances and assertions not otherwise tested due to their materiality or risk.
- Adjusting the timing of audit procedures from that otherwise expected.
- Using different sampling methods.

[19] HKSA 315 (Revised), paragraph A56

- Performing audit procedures at different locations or at locations on an unannounced basis.

Audit Procedures Responsive to Assessed Risks of Material Misstatement Due to Fraud at the Assertion Level (Ref: Para. 31)

A38. The auditor's responses to address the assessed risks of material misstatement due to fraud at the assertion level may include changing the nature, timing and extent of audit procedures in the following ways:

- The nature of audit procedures to be performed may need to be changed to obtain audit evidence that is more reliable and relevant or to obtain additional corroborative information. This may affect both the type of audit procedures to be performed and their combination. For example:

    - Physical observation or inspection of certain assets may become more important or the auditor may choose to use computer-assisted audit techniques to gather more evidence about data contained in significant accounts or electronic transaction files.

    - The auditor may design procedures to obtain additional corroborative information. For example, if the auditor identifies that management is under pressure to meet earnings expectations, there may be a related risk that management is inflating sales by entering into sales agreements that include terms that preclude revenue recognition or by invoicing sales before delivery. In these circumstances, the auditor may, for example, design external confirmations not only to confirm outstanding amounts, but also to confirm the details of the sales agreements, including date, any rights of return and delivery terms. In addition, the auditor might find it effective to supplement such external confirmations with inquiries of non-financial personnel in the entity regarding any changes in sales agreements and delivery terms.

- The timing of substantive procedures may need to be modified. The auditor may conclude that performing substantive testing at or near the period end better addresses an assessed risk of material misstatement due to fraud. The auditor may conclude that, given the assessed risks of intentional misstatement or manipulation, audit procedures to extend audit conclusions from an interim date to the period end would not be effective. In contrast, because an intentional misstatement—for example, a misstatement involving improper revenue recognition—may have been initiated in an interim period, the auditor may elect to apply substantive procedures to transactions occurring earlier in or throughout the reporting period.

- The extent of the procedures applied reflects the assessment of the risks of material misstatement due to fraud. For example, increasing sample sizes or performing analytical procedures at a more detailed level may be appropriate. Also, computer-assisted audit techniques may enable more extensive testing of electronic transactions and account files. Such techniques can be used to select sample transactions from key electronic files, to sort transactions with specific characteristics, or to test an entire population instead of a sample.

A39. If the auditor identifies a risk of material misstatement due to fraud that affects inventory quantities, examining the entity's inventory records may help to identify locations or items that require specific attention during or after the physical inventory count. Such a review may lead to a decision to observe inventory counts at certain locations on an unannounced basis or to conduct inventory counts at all locations on the same date.

A40. The auditor may identify a risk of material misstatement due to fraud affecting a number of accounts and assertions. These may include asset valuation, estimates relating to specific transactions (such as acquisitions, restructurings, or disposals of a segment of the business), and other significant accrued liabilities (such as pension and other post-employment benefit obligations, or environmental remediation liabilities). The risk may also relate to significant changes in assumptions relating to recurring estimates. Information gathered through obtaining an understanding of the entity and its environment may assist the auditor in evaluating the reasonableness of such management estimates and underlying judgments and assumptions. A retrospective review of similar management judgments and assumptions applied in prior periods may also provide insight about the reasonableness of judgments and assumptions supporting management estimates.

A41. Examples of possible audit procedures to address the assessed risks of material misstatement due to fraud, including those that illustrate the incorporation of an element of unpredictability, are presented in Appendix 2. The appendix includes examples of responses to the auditor's assessment of the risks of material misstatement resulting from both fraudulent financial reporting, including fraudulent financial reporting resulting from revenue recognition, and misappropriation of assets.

Audit Procedures Responsive to Risks Related to Management Override of Controls

Journal Entries and Other Adjustments (Ref: Para. 33(a))

A42. Material misstatement of financial statements due to fraud often involve the manipulation of the financial reporting process by recording inappropriate or unauthorized journal entries. This may occur throughout the year or at period end, or by management making adjustments to amounts reported in the financial statements that are not reflected in journal entries, such as through consolidating adjustments and reclassifications.

A43. Further, the auditor's consideration of the risks of material misstatement associated with inappropriate override of controls over journal entries is important since automated processes and controls may reduce the risk of inadvertent error but do not overcome the risk that individuals may inappropriately override such automated processes, for example, by changing the amounts being automatically passed to the general ledger or to the financial reporting system. Furthermore, where IT is used to transfer information automatically, there may be little or no visible evidence of such intervention in the information systems.

A44. When identifying and selecting journal entries and other adjustments for testing and determining the appropriate method of examining the underlying support for the items selected, the following matters are of relevance:

- *The assessment of the risks of material misstatement due to fraud* – the presence of fraud risk factors and other information obtained during the auditor's assessment of the risks of material misstatement due to fraud may assist the auditor to identify specific classes of journal entries and other adjustments for testing.

- *Controls that have been implemented over journal entries and other adjustments* – effective controls over the preparation and posting of journal entries and other adjustments may reduce the extent of substantive testing necessary, provided that the auditor has tested the operating effectiveness of the controls.

- *The entity's financial reporting process and the nature of evidence that can be obtained* – for many entities routine processing of transactions involves a combination of manual and automated steps and procedures. Similarly, the processing of journal entries and other adjustments may involve both manual and automated procedures and controls. Where information technology is used in the financial reporting process, journal entries and other adjustments may exist only in electronic form.

- *The characteristics of fraudulent journal entries or other adjustments* – inappropriate journal entries or other adjustments often have unique identifying characteristics. Such characteristics may include entries (a) made to unrelated, unusual, or seldom-used accounts, (b) made by individuals who typically do not make journal entries, (c) recorded at the end of the period or as post-closing entries that have little or no explanation or description, (d) made either before or during the preparation of the financial statements that do not have account numbers, or (e) containing round numbers or consistent ending numbers.

- *The nature and complexity of the accounts* – inappropriate journal entries or adjustments may be applied to accounts that (a) contain transactions that are complex or unusual in nature, (b) contain significant estimates and period-end adjustments, (c) have been prone to misstatements in the past, (d) have not been reconciled on a timely basis or contain unreconciled differences, (e) contain inter-company transactions, or (f) are otherwise associated with an identified risk of material misstatement due to fraud. In audits of entities that have several locations or components, consideration is given to the need to select journal entries from multiple locations.

- *Journal entries or other adjustments processed outside the normal course of business* – non standard journal entries may not be subject to the same level of internal control as those journal entries used on a recurring basis to record transactions such as monthly sales, purchases and cash disbursements.

A45. The auditor uses professional judgment in determining the nature, timing and extent of testing of journal entries and other adjustments. However, because fraudulent journal entries and other adjustments are often made at the end of a reporting period, paragraph 33(a)(ii) requires the auditor to select the journal entries and other adjustments made at that time. Further, because material misstatements in financial statements due to fraud can occur throughout the period and may involve extensive efforts to conceal how the fraud is accomplished, paragraph 33(a)(iii) requires the auditor to consider whether there is also a need to test journal entries and other adjustments throughout the period.

Accounting Estimates (Ref: Para. 33(b))

A46. The preparation of the financial statements requires management to make a number of judgments or assumptions that affect significant accounting estimates and to monitor the reasonableness of such estimates on an ongoing basis. Fraudulent financial reporting is often accomplished through intentional misstatement of accounting estimates. This may be achieved by, for example, understating or overstating all provisions or reserves in the same fashion so as to be designed either to smooth earnings over two or more accounting periods, or to achieve a designated earnings level in order to deceive financial statement users by influencing their perceptions as to the entity's performance and profitability.

A47. The purpose of performing a retrospective review of management judgments and assumptions related to significant accounting estimates reflected in the financial statements of the prior year is to determine whether there is an indication of a possible bias on the part of management. It is not intended to call into question the auditor's professional judgments made in the prior year that were based on information available at the time.

A48. A retrospective review is also required by HKSA 540.[20] That review is conducted as a risk assessment procedure to obtain information regarding the effectiveness of management's prior period estimation process, audit evidence about the outcome, or where applicable, the subsequent re-estimation of prior period accounting estimates that is pertinent to making current period accounting estimates, and audit evidence of matters, such as estimation uncertainty, that may be required to be disclosed in the financial statements. As a practical matter, the auditor's review of management judgments and assumptions for biases that could

[20] HKSA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*, paragraph 9

represent a risk of material misstatement due to fraud in accordance with this HKSA may be carried out in conjunction with the review required by HKSA 540.

Business Rationale for Significant Transactions (Ref: Para. 33(c))

A49. Indicators that may suggest that significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual, may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets include:

- The form of such transactions appears overly complex (for example, the transaction involves multiple entities within a consolidated group or multiple unrelated third parties).
- Management has not discussed the nature of and accounting for such transactions with those charged with governance of the entity, and there is inadequate documentation.
- Management is placing more emphasis on the need for a particular accounting treatment than on the underlying economics of the transaction.
- Transactions that involve non-consolidated related parties, including special purpose entities, have not been properly reviewed or approved by those charged with governance of the entity.
- The transactions involve previously unidentified related parties or parties that do not have the substance or the financial strength to support the transaction without assistance from the entity under audit.

Evaluation of Audit Evidence (Ref: Para. 35-38)

A50. HKSA 330 requires the auditor, based on the audit procedures performed and the audit evidence obtained, to evaluate whether the assessments of the risks of material misstatement at the assertion level remain appropriate.[21] This evaluation is primarily a qualitative matter based on the auditor's judgment. Such an evaluation may provide further insight about the risks of material misstatement due to fraud and whether there is a need to perform additional or different audit procedures. Appendix 3 contains examples of circumstances that may indicate the possibility of fraud.

Analytical Procedures Performed Near the End of the Audit in Forming an Overall Conclusion (Ref: Para. 35)

A51. Determining which particular trends and relationships may indicate a risk of material misstatement due to fraud requires professional judgment. Unusual relationships involving year-end revenue and income are particularly relevant. These might include, for example: uncharacteristically large amounts of income being reported in the last few weeks of the reporting period or unusual transactions; or income that is inconsistent with trends in cash flow from operations.

Consideration of Identified Misstatements (Ref: Para. 36-38)

A52. Since fraud involves incentive or pressure to commit fraud, a perceived opportunity to do so or some rationalization of the act, an instance of fraud is unlikely to be an isolated occurrence. Accordingly, misstatements, such as numerous misstatements at a specific location even though the cumulative effect is not material, may be indicative of a risk of material misstatement due to fraud.

A53. The implications of identified fraud depend on the circumstances. For example, an otherwise insignificant fraud may be significant if it involves senior management. In such circumstances,

[21] HKSA 330, paragraph 25

the reliability of evidence previously obtained may be called into question, since there may be doubts about the completeness and truthfulness of representations made and about the genuineness of accounting records and documentation. There may also be a possibility of collusion involving employees, management or third parties.

A54. HKSA 450[22] and HKSA 700 (Revised)[23] establish requirements and provide guidance on the evaluation and disposition of misstatements and the effect on the auditor's opinion in the auditor's report.

Auditor Unable to Continue the Engagement (Ref: Para. 39)

A55. Examples of exceptional circumstances that may arise and that may bring into question the auditor's ability to continue performing the audit include:

- The entity does not take the appropriate action regarding fraud that the auditor considers necessary in the circumstances, even where the fraud is not material to the financial statements;
- The auditor's consideration of the risks of material misstatement due to fraud and the results of audit tests indicate a significant risk of material and pervasive fraud; or
- The auditor has significant concern about the competence or integrity of management or those charged with governance.

A56. Because of the variety of the circumstances that may arise, it is not possible to describe definitively when withdrawal from an engagement is appropriate. Factors that affect the auditor's conclusion include the implications of the involvement of a member of management or of those charged with governance (which may affect the reliability of management representations) and the effects on the auditor of a continuing association with the entity.

A57. The auditor has professional and legal responsibilities in such circumstances and these responsibilities may vary by country. In some countries, for example, the auditor may be entitled to, or required to, make a statement or report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities. Given the exceptional nature of the circumstances and the need to consider the legal requirements, the auditor may consider it appropriate to seek legal advice when deciding whether to withdraw from an engagement and in determining an appropriate course of action, including the possibility of reporting to shareholders, regulators or others.[24]

Considerations Specific to Public Sector Entities

A58. In many cases in the public sector, the option of withdrawing from the engagement may not be available to the auditor due to the nature of the mandate or public interest considerations.

Written Representations (Ref: Para. 40)

A59. HKSA 580[25] establishes requirements and provides guidance on obtaining appropriate representations from management and, where appropriate, those charged with governance in the audit. In addition to acknowledging that they have fulfilled their responsibility for the preparation of the financial statements, it is important that, irrespective of the size of the entity, management and, where appropriate, those charged with governance acknowledge their responsibility for internal control designed, implemented and maintained to prevent and detect fraud.

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[22] HKSA 450, *Evaluation of Misstatements Identified during the Audit*

[23] HKSA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

[24] The HKICPA *Code of Ethics for Professional Accountants* provides guidance on communications with an auditor replacing the existing auditor.

[25] HKSA 580, *Written Representations*

A60. Because of the nature of fraud and the difficulties encountered by auditors in detecting material misstatements in the financial statements resulting from fraud, it is important that the auditor obtain a written representation from management and, where appropriate, those charged with governance confirming that they have disclosed to the auditor:

(a) The results of management's assessment of the risk that the financial statements may be materially misstated as a result of fraud; and

(b) Their knowledge of actual, suspected or alleged fraud affecting the entity.

Communications to Management and with Those Charged with Governance (Ref: Para. 41–43)

A61. In some jurisdictions, law or regulation may restrict the auditor's communication of certain matters with management and those charged with governance. Law or regulation may specifically prohibit a communication, or other action, that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act, including alerting the entity, for example, when the auditor is required to report the fraud to an appropriate authority pursuant to anti-money laundering legislation.[25a] In these circumstances, the issues considered by the auditor may be complex and the auditor may consider it appropriate to obtain legal advice.

Communication to Management (Ref: Para. 41)

A62. When the auditor has obtained evidence that fraud exists or may exist, it is important that the matter be brought to the attention of the appropriate level of management as soon as practicable. This is so even if the matter might be considered inconsequential (for example, a minor defalcation by an employee at a low level in the entity's organization). The determination of which level of management is the appropriate one is a matter of professional judgment and is affected by such factors as the likelihood of collusion and the nature and magnitude of the suspected fraud. Ordinarily, the appropriate level of management is at least one level above the persons who appear to be involved with the suspected fraud.

Communication with Those Charged with Governance (Ref: Para. 42)

A63. The auditor's communication with those charged with governance may be made orally or in writing. HKSA 260 (Revised) identifies factors the auditor considers in determining whether to communicate orally or in writing.[26] Due to the nature and sensitivity of fraud involving senior management, or fraud that results in a material misstatement in the financial statements, the auditor reports such matters on a timely basis and may consider it necessary to also report such matters in writing.

A64. In some cases, the auditor may consider it appropriate to communicate with those charged with governance when the auditor becomes aware of fraud involving employees other than management that does not result in a material misstatement. Similarly, those charged with governance may wish to be informed of such circumstances. The communication process is assisted if the auditor and those charged with governance agree at an early stage in the audit about the nature and extent of the auditor's communications in this regard.

A65. In the exceptional circumstances where the auditor has doubts about the integrity or honesty of management or those charged with governance, the auditor may consider it appropriate to obtain legal advice to assist in determining the appropriate course of action.

[25a] Additional guidance is provided in Appendix 4 of HKSA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*.

[26] HKSA 260 (Revised), paragraph A38

Other Matters Related to Fraud (Ref: Para. 43)

A66. Other matters related to fraud to be discussed with those charged with governance of the entity may include, for example:

- Concerns about the nature, extent and frequency of management's assessments of the controls in place to prevent and detect fraud and of the risk that the financial statements may be misstated.
- A failure by management to appropriately address identified significant deficiencies in internal control, or to appropriately respond to an identified fraud.
- The auditor's evaluation of the entity's control environment, including questions regarding the competence and integrity of management.
- Actions by management that may be indicative of fraudulent financial reporting, such as management's selection and application of accounting policies that may be indicative of management's effort to manage earnings in order to deceive financial statement users by influencing their perceptions as to the entity's performance and profitability.
- Concerns about the adequacy and completeness of the authorization of transactions that appear to be outside the normal course of business.

Reporting Fraud to an Appropriate Authority outside the Entity (Ref: Para. 44)

A67. HKSA 250 (Revised)[27] provides further guidance with respect to the auditor's determination of whether reporting identified or suspected non-compliance with laws or regulations to an appropriate authority outside the entity is required or appropriate in the circumstances, including consideration of the auditor's duty of confidentiality.

A68. The determination required by paragraph 44 may involve complex considerations and professional judgments. Accordingly, he auditor may consider consulting internally (e.g., within the firm or a network firm) or on a confidential basis with a regulator or professional body (unless doing so is prohibited by law or regulation or would breach the duty of confidentiality). The auditor may also consider obtaining legal advice to understand the auditor's options and the professional or legal implications of taking any particular course of action.

Considerations Specific to Public Sector Entities

A69. In the public sector, requirements for reporting fraud, whether or not discovered through the audit process, may be subject to specific provisions of the audit mandate or related law, regulation or other authority.

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[27] HKSA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements,* paragraphs A28–A34

Appendix 1

(Ref: Para. A26)

Examples of Fraud Risk Factors

The fraud risk factors identified in this Appendix are examples of such factors that may be faced by auditors in a broad range of situations. Separately presented are examples relating to the two types of fraud relevant to the auditor's consideration – that is, fraudulent financial reporting and misappropriation of assets. For each of these types of fraud, the risk factors are further classified based on the three conditions generally present when material misstatements due to fraud occur: (a) incentives/pressures, (b) opportunities, and (c) attitudes/rationalizations. Although the risk factors cover a broad range of situations, they are only examples and, accordingly, the auditor may identify additional or different risk factors. Not all of these examples are relevant in all circumstances, and some may be of greater or lesser significance in entities of different size or with different ownership characteristics or circumstances. Also, the order of the examples of risk factors provided is not intended to reflect their relative importance or frequency of occurrence.

Risk Factors Relating to Misstatements Arising from Fraudulent Financial Reporting

The following are examples of risk factors relating to misstatements arising from fraudulent financial reporting.

Incentives/Pressures

Financial stability or profitability is threatened by economic, industry, or entity operating conditions, such as (or as indicated by):

- High degree of competition or market saturation, accompanied by declining margins.
- High vulnerability to rapid changes, such as changes in technology, product obsolescence, or interest rates.
- Significant declines in customer demand and increasing business failures in either the industry or overall economy.
- Operating losses making the threat of bankruptcy, foreclosure, or hostile takeover imminent.
- Recurring negative cash flows from operations or an inability to generate cash flows from operations while reporting earnings and earnings growth.
- Rapid growth or unusual profitability especially compared to that of other companies in the same industry.
- New accounting, statutory, or regulatory requirements.

Excessive pressure exists for management to meet the requirements or expectations of third parties due to the following:

- Profitability or trend level expectations of investment analysts, institutional investors, significant creditors, or other external parties (particularly expectations that are unduly aggressive or unrealistic), including expectations created by management in, for example, overly optimistic press releases or annual report messages.
- Need to obtain additional debt or equity financing to stay competitive – including financing of major research and development or capital expenditures.

- Marginal ability to meet exchange listing requirements or debt repayment or other debt covenant requirements.

- Perceived or real adverse effects of reporting poor financial results on significant pending transactions, such as business combinations or contract awards.

Information available indicates that the personal financial situation of management or those charged with governance is threatened by the entity's financial performance arising from the following:

- Significant financial interests in the entity.

- Significant portions of their compensation (for example, bonuses, stock options, and earn-out arrangements) being contingent upon achieving aggressive targets for stock price, operating results, financial position, or cash flow.[1]

- Personal guarantees of debts of the entity.

There is excessive pressure on management or operating personnel to meet financial targets established by those charged with governance, including sales or profitability incentive goals.

Opportunities

The nature of the industry or the entity's operations provides opportunities to engage in fraudulent financial reporting that can arise from the following:

- Significant related-party transactions not in the ordinary course of business or with related entities not audited or audited by another firm.

- A strong financial presence or ability to dominate a certain industry sector that allows the entity to dictate terms or conditions to suppliers or customers that may result in inappropriate or non-arm's-length transactions.

- Assets, liabilities, revenues, or expenses based on significant estimates that involve subjective judgments or uncertainties that are difficult to corroborate.

- Significant, unusual, or highly complex transactions, especially those close to period end that pose difficult "substance over form" questions.

- Significant operations located or conducted across international borders in jurisdictions where differing business environments and cultures exist.

- Use of business intermediaries for which there appears to be no clear business justification.

- Significant bank accounts or subsidiary or branch operations in tax-haven jurisdictions for which there appears to be no clear business justification.

The monitoring of management is not effective as a result of the following:

- Domination of management by a single person or small group (in a non owner-managed business) without compensating controls.

- Oversight by those charged with governance over the financial reporting process and internal control is not effective.

[1] Management incentive plans may be contingent upon achieving targets relating only to certain accounts or selected activities of the entity, even though the related accounts or activities may not be material to the entity as a whole.

There is a complex or unstable organizational structure, as evidenced by the following:

- Difficulty in determining the organization or individuals that have controlling interest in the entity.
- Overly complex organizational structure involving unusual legal entities or managerial lines of authority.
- High turnover of senior management, legal counsel, or those charged with governance.

Internal control components are deficient as a result of the following:

- Inadequate monitoring of controls, including automated controls and controls over interim financial reporting (where external reporting is required).
- High turnover rates or employment of staff in accounting, information technology, or the internal audit function that are not effective.
- Accounting and information systems that are not effective, including situations involving significant deficiencies in internal control.

Attitudes/Rationalizations

- Communication, implementation, support, or enforcement of the entity's values or ethical standards by management, or the communication of inappropriate values or ethical standards, that are not effective.
- Nonfinancial management's excessive participation in or preoccupation with the selection of accounting policies or the determination of significant estimates.
- Known history of violations of securities laws or other laws and regulations, or claims against the entity, its senior management, or those charged with governance alleging fraud or violations of laws and regulations.
- Excessive interest by management in maintaining or increasing the entity's stock price or earnings trend.
- The practice by management of committing to analysts, creditors, and other third parties to achieve aggressive or unrealistic forecasts.
- Management failing to remedy known significant deficiencies in internal control on a timely basis.
- An interest by management in employing inappropriate means to minimize reported earnings for tax-motivated reasons.
- Low morale among senior management.
- The owner-manager makes no distinction between personal and business transactions.
- Dispute between shareholders in a closely held entity.
- Recurring attempts by management to justify marginal or inappropriate accounting on the basis of materiality.
- The relationship between management and the current or predecessor auditor is strained, as exhibited by the following:

- Frequent disputes with the current or predecessor auditor on accounting, auditing, or reporting matters.

- Unreasonable demands on the auditor, such as unrealistic time constraints regarding the completion of the audit or the issuance of the auditor's report.

- Restrictions on the auditor that inappropriately limit access to people or information or the ability to communicate effectively with those charged with governance.

- Domineering management behavior in dealing with the auditor, especially involving attempts to influence the scope of the auditor's work or the selection or continuance of personnel assigned to or consulted on the audit engagement.

Risk Factors Arising from Misstatements Arising from Misappropriation of Assets

Risk factors that relate to misstatements arising from misappropriation of assets are also classified according to the three conditions generally present when fraud exists: incentives/pressures, opportunities, and attitudes/rationalization. Some of the risk factors related to misstatements arising from fraudulent financial reporting also may be present when misstatements arising from misappropriation of assets occur. For example, ineffective monitoring of management and other deficiencies in internal control may be present when misstatements due to either fraudulent financial reporting or misappropriation of assets exist. The following are examples of risk factors related to misstatements arising from misappropriation of assets.

Incentives/Pressures

Personal financial obligations may create pressure on management or employees with access to cash or other assets susceptible to theft to misappropriate those assets.

Adverse relationships between the entity and employees with access to cash or other assets susceptible to theft may motivate those employees to misappropriate those assets. For example, adverse relationships may be created by the following:

- Known or anticipated future employee layoffs.

- Recent or anticipated changes to employee compensation or benefit plans.

- Promotions, compensation, or other rewards inconsistent with expectations.

Opportunities

Certain characteristics or circumstances may increase the susceptibility of assets to misappropriation. For example, opportunities to misappropriate assets increase when there are the following:

- Large amounts of cash on hand or processed.

- Inventory items that are small in size, of high value, or in high demand.

- Easily convertible assets, such as bearer bonds, diamonds, or computer chips.

- Fixed assets which are small in size, marketable, or lacking observable identification of ownership.

Inadequate internal control over assets may increase the susceptibility of misappropriation of those assets. For example, misappropriation of assets may occur because there is the following:

- Inadequate segregation of duties or independent checks.
- Inadequate oversight of senior management expenditures, such as travel and other re-imbursements.
- Inadequate management oversight of employees responsible for assets, for example, inadequate supervision or monitoring of remote locations.
- Inadequate job applicant screening of employees with access to assets.
- Inadequate record keeping with respect to assets.
- Inadequate system of authorization and approval of transactions (for example, in purchasing).
- Inadequate physical safeguards over cash, investments, inventory, or fixed assets.
- Lack of complete and timely reconciliations of assets.
- Lack of timely and appropriate documentation of transactions, for example, credits for merchandise returns.
- Lack of mandatory vacations for employees performing key control functions.
- Inadequate management understanding of information technology, which enables information technology employees to perpetrate a misappropriation.
- Inadequate access controls over automated records, including controls over and review of computer systems event logs.

Attitudes/Rationalizations

- Disregard for the need for monitoring or reducing risks related to misappropriations of assets.
- Disregard for internal control over misappropriation of assets by overriding existing controls or by failing to take appropriate remedial action on known deficiencies in internal control.
- Behavior indicating displeasure or dissatisfaction with the entity or its treatment of the employee.
- Changes in behavior or lifestyle that may indicate assets have been misappropriated.
- Tolerance of petty theft.

Appendix 2

(Ref: Para. A41)

Examples of Possible Audit Procedures to Address the Assessed Risks of Material Misstatement Due to Fraud

The following are examples of possible audit procedures to address the assessed risks of material misstatement due to fraud resulting from both fraudulent financial reporting and misappropriation of assets. Although these procedures cover a broad range of situations, they are only examples and, accordingly they may not be the most appropriate nor necessary in each circumstance. Also the order of the procedures provided is not intended to reflect their relative importance.

Consideration at the Assertion Level

Specific responses to the auditor's assessment of the risks of material misstatement due to fraud will vary depending upon the types or combinations of fraud risk factors or conditions identified, and the classes of transactions, account balances, disclosures and assertions they may affect.

The following are specific examples of responses:

- Visiting locations or performing certain tests on a surprise or unannounced basis. For example, observing inventory at locations where auditor attendance has not been previously announced or counting cash at a particular date on a surprise basis.

- Requesting that inventories be counted at the end of the reporting period or on a date closer to period end to minimize the risk of manipulation of balances in the period between the date of completion of the count and the end of the reporting period.

- Altering the audit approach in the current year. For example, contacting major customers and suppliers orally in addition to sending written confirmation, sending confirmation requests to a specific party within an organization, or seeking more or different information.

- Performing a detailed review of the entity's quarter-end or year-end adjusting entries and investigating any that appear unusual as to nature or amount.

- For significant and unusual transactions, particularly those occurring at or near year-end, investigating the possibility of related parties and the sources of financial resources supporting the transactions.

- Performing substantive analytical procedures using disaggregated data. For example, comparing sales and cost of sales by location, line of business or month to expectations developed by the auditor.

- Conducting interviews of personnel involved in areas where a risk of material misstatement due to fraud has been identified, to obtain their insights about the risk and whether, or how, controls address the risk.

- When other independent auditors are auditing the financial statements of one or more subsidiaries, divisions or branches, discussing with them the extent of work necessary to be performed to address the assessed risk of material misstatement due to fraud resulting from transactions and activities among these components.

- If the work of an expert becomes particularly significant with respect to a financial statement item for which the assessed risk of misstatement due to fraud is high, performing additional procedures relating to some or all of the expert's assumptions, methods or findings to determine that the findings are not unreasonable, or engaging another expert for that purpose.

- Performing audit procedures to analyze selected opening balance sheet accounts of previously audited financial statements to assess how certain issues involving accounting estimates and judgments, for example, an allowance for sales returns, were resolved with the benefit of hindsight.

- Performing procedures on account or other reconciliations prepared by the entity, including considering reconciliations performed at interim periods.

- Performing computer-assisted techniques, such as data mining to test for anomalies in a population.

- Testing the integrity of computer-produced records and transactions.

- Seeking additional audit evidence from sources outside of the entity being audited.

Specific Responses—Misstatement Resulting from Fraudulent Financial Reporting

Examples of responses to the auditor's assessment of the risks of material misstatement due to fraudulent financial reporting are as follows:

Revenue Recognition

- Performing substantive analytical procedures relating to revenue using disaggregated data, for example, comparing revenue reported by month and by product line or business segment during the current reporting period with comparable prior periods. Computer-assisted audit techniques may be useful in identifying unusual or unexpected revenue relationships or transactions.

- Confirming with customers certain relevant contract terms and the absence of side agreements, because the appropriate accounting often is influenced by such terms or agreements and basis for rebates or the period to which they relate are often poorly documented. For example, acceptance criteria, delivery and payment terms, the absence of future or continuing vendor obligations, the right to return the product, guaranteed resale amounts, and cancellation or refund provisions often are relevant in such circumstances.

- Inquiring of the entity's sales and marketing personnel or in-house legal counsel regarding sales or shipments near the end of the period and their knowledge of any unusual terms or conditions associated with these transactions.

- Being physically present at one or more locations at period end to observe goods being shipped or being readied for shipment (or returns awaiting processing) and performing other appropriate sales and inventory cutoff procedures.

- For those situations for which revenue transactions are electronically initiated, processed, and recorded, testing controls to determine whether they provide assurance that recorded revenue transactions occurred and are properly recorded.

Inventory Quantities

- Examining the entity's inventory records to identify locations or items that require specific attention during or after the physical inventory count.
- Observing inventory counts at certain locations on an unannounced basis or conducting inventory counts at all locations on the same date.
- Conducting inventory counts at or near the end of the reporting period to minimize the risk of inappropriate manipulation during the period between the count and the end of the reporting period.
- Performing additional procedures during the observation of the count, for example, more rigorously examining the contents of boxed items, the manner in which the goods are stacked (for example, hollow squares) or labeled, and the quality (that is, purity, grade, or concentration) of liquid substances such as perfumes or specialty chemicals. Using the work of an expert may be helpful in this regard.
- Comparing the quantities for the current period with prior periods by class or category of inventory, location or other criteria, or comparison of quantities counted with perpetual records.
- Using computer-assisted audit techniques to further test the compilation of the physical inventory counts – for example, sorting by tag number to test tag controls or by item serial number to test the possibility of item omission or duplication.

Management Estimates

- Using an expert to develop an independent estimate for comparison to management's estimate.
- Extending inquiries to individuals outside of management and the accounting department to corroborate management's ability and intent to carry out plans that are relevant to developing the estimate.

Specific Responses—Misstatements Due to Misappropriation of Assets

Differing circumstances would necessarily dictate different responses. Ordinarily, the audit response to an assessed risk of material misstatement due to fraud relating to misappropriation of assets will be directed toward certain account balances and classes of transactions. Although some of the audit responses noted in the two categories above may apply in such circumstances, the scope of the work is to be linked to the specific information about the misappropriation risk that has been identified.

Examples of responses to the auditor's assessment of the risk of material misstatements due to misappropriation of assets are as follows:

- Counting cash or securities at or near year-end.
- Confirming directly with customers the account activity (including credit memo and sales return activity as well as dates payments were made) for the period under audit.
- Analyzing recoveries of written-off accounts.
- Analyzing inventory shortages by location or product type.
- Comparing key inventory ratios to industry norm.

- Reviewing supporting documentation for reductions to the perpetual inventory records.
- Performing a computerized match of the vendor list with a list of employees to identify matches of addresses or phone numbers.
- Performing a computerized search of payroll records to identify duplicate addresses, employee identification or taxing authority numbers or bank accounts.
- Reviewing personnel files for those that contain little or no evidence of activity, for example, lack of performance evaluations.
- Analyzing sales discounts and returns for unusual patterns or trends.
- Confirming specific terms of contracts with third parties.
- Obtaining evidence that contracts are being carried out in accordance with their terms.
- Reviewing the propriety of large and unusual expenses.
- Reviewing the authorization and carrying value of senior management and related party loans.
- Reviewing the level and propriety of expense reports submitted by senior management.

Appendix 3

(Ref: Para. A50)

Examples of Circumstances that Indicate the Possibility of Fraud

The following are examples of circumstances that may indicate the possibility that the financial statements may contain a material misstatement resulting from fraud.

Discrepancies in the accounting records, including:

- Transactions that are not recorded in a complete or timely manner or are improperly recorded as to amount, accounting period, classification, or entity policy.
- Unsupported or unauthorized balances or transactions.
- Last-minute adjustments that significantly affect financial results.
- Evidence of employees' access to systems and records inconsistent with that necessary to perform their authorized duties.
- Tips or complaints to the auditor about alleged fraud.

Conflicting or missing evidence, including:

- Missing documents.
- Documents that appear to have been altered.
- Unavailability of other than photocopied or electronically transmitted documents when documents in original form are expected to exist.
- Significant unexplained items on reconciliations.
- Unusual balance sheet changes, or changes in trends or important financial statement ratios or relationships – for example, receivables growing faster than revenues.
- Inconsistent, vague, or implausible responses from management or employees arising from inquiries or analytical procedures.
- Unusual discrepancies between the entity's records and confirmation replies.
- Large numbers of credit entries and other adjustments made to accounts receivable records.
- Unexplained or inadequately explained differences between the accounts receivable sub-ledger and the control account, or between the customer statements and the accounts receivable sub-ledger.
- Missing or non-existent cancelled checks in circumstances where cancelled checks are ordinarily returned to the entity with the bank statement.
- Missing inventory or physical assets of significant magnitude.
- Unavailable or missing electronic evidence, inconsistent with the entity's record retention practices or policies.

- Fewer responses to confirmations than anticipated or a greater number of responses than anticipated.

- Inability to produce evidence of key systems development and program change testing and implementation activities for current-year system changes and deployments.

Problematic or unusual relationships between the auditor and management, including:

- Denial of access to records, facilities, certain employees, customers, vendors, or others from whom audit evidence might be sought.

- Undue time pressures imposed by management to resolve complex or contentious issues.

- Complaints by management about the conduct of the audit or management intimidation of engagement team members, particularly in connection with the auditor's critical assessment of audit evidence or in the resolution of potential disagreements with management.

- Unusual delays by the entity in providing requested information.

- Unwillingness to facilitate auditor access to key electronic files for testing through the use of computer-assisted audit techniques.

- Denial of access to key IT operations staff and facilities, including security, operations, and systems development personnel.

- An unwillingness to add or revise disclosures in the financial statements to make them more complete and understandable.

- An unwillingness to address identified deficiencies in internal control on a timely basis.

Other

- Unwillingness by management to permit the auditor to meet privately with those charged with governance.

- Accounting policies that appear to be at variance with industry norms.

- Frequent changes in accounting estimates that do not appear to result from changed circumstances.

- Tolerance of violations of the entity's code of conduct.

Appendix 4

(Ref: Para. 44)

Additional local guidance on Reporting Fraud to an Appropriate Authority Outside the Entity

1. This appendix provide guidance to an auditor on the circumstances in which to report to third parties who have a proper interest in receiving such information. In addition, an auditor of entities in regulated industries, who is required to report certain information direct to the relevant regulators, has separate responsibilities. Guidance on the auditor's responsibility to report direct to regulators in regulated industries is provided in Practice Note 820 (Revised), *The Audit of Licensed Corporations and Associated Entities of Intermediaries*, Practice Note 620.2 *Communication between the Auditor and the Insurance Authority*, Practice Note 860.1 (Revised), *The Audit of Retirement Schemes* and Practice Note 830 (Revised), *Reports by the Auditor under the Banking Ordinance*.

2. Where the auditor becomes aware of a suspected or actual instance of fraud which could have a material effect on the financial statements, he would:

   (a) consider whether the matter may be one that ought to be reported to a proper authority in the public interest; and where this is the case

   (b) except when he is prohibited by law from informing any party other than the proper authority or when the matter casts doubt on the integrity of those charged with governance, discuss the matter with those charged with governance, including any audit committee.

3. Where having discussed an identified suspected or actual instance of fraud which could have a material effect on the financial statements with those charged with governance and considered any views expressed on behalf of the entity and in the light of any legal advice obtained, the auditor concludes that the matter ought to be reported to a proper authority in the public interest, he would, except in the circumstances covered in paragraph 5(b) below, notify those charged with governance in writing of his view. If the entity does not voluntarily report the matter to a proper authority itself or is unable to provide evidence that the matter has been reported, the auditor would consider reporting it himself.

4. Confidentiality is an implied term of the auditor's contract. The duty of confidentiality, however, is not absolute. In certain exceptional circumstances an auditor is not bound by the duty of confidentiality and may report a suspected or actual instance of fraud which could have a material effect on the financial statements to a proper authority in the public interest. An auditor needs to weigh the public interest in maintaining confidential client relationships against the public interest in disclosure to a proper authority. Determination of where the balance of public interest lies requires careful consideration. An auditor whose suspicions has been aroused needs to use his professional judgment to determine whether his misgivings justify him in carrying the matter further or are too insubstantial to deserve reporting.

5. In respect of an identified suspected or actual instance of fraud which could have a material effect on the financial statements, the auditor would make a report direct to a proper authority in the public interest without delay and without informing those charged with governance in advance in situations where:

   (a) the auditor concludes that the matter ought to be reported to a proper authority in the public interest; and

   (b) the auditor is prohibited by law from informing any party other than the proper authority or the matter casts doubt on the integrity of those charged with governance.

6. Examples of circumstances which may cause the auditor no longer to have confidence in the integrity of those charged with governance include situations:

   (a) where he suspects or has evidence of the involvement or intended involvement of those charged with governance in possible fraud which could have a material effect on the financial statements; or

   (b) where he suspects or has evidence that those charged with governance are aware of such fraud and, contrary to regulatory requirements or the public interest, have not reported it to a proper authority within a reasonable period.

7. "Public interest" is a concept that is not capable of general definition. Each situation must be considered individually. Matters to be taken into account when considering whether disclosure is justified in the public interest may include:

   (a) the extent to which the suspected or actual fraud is likely to affect members of the public;

   (b) whether those charged with governance have rectified the matter or are taking, or are likely to take, effective corrective action;

   (c) the extent to which non-disclosure is likely to enable the suspected or actual fraud to recur with impunity;

   (d) the gravity of the matter; and

   (e) the weight of evidence and the degree of the auditor's suspicion that there has been an instance of fraud.

8. When reporting to proper authorities in the public interest it is important that an auditor only reports to one which has a proper interest to receive the information. Which body or person is the proper authority in a particular instance depends on the nature of the suspected or actual fraud. Proper authorities could include the Independent Commission Against Corruption, the Police, the Customs and Excise Department, the Joint Financial Intelligence Unit, Hong Kong Exchanges and Clearing Limited, the Securities and Futures Commission, the Hong Kong Monetary Authority, the Insurance Authority or the Mandatory Provident Fund Schemes Authority. In cases of doubt as to the appropriate authority an auditor is advised to seek legal advice.

9. An auditor receives the same protection even if he only has a reasonable suspicion that fraud has occurred. An auditor who can demonstrate that he has acted reasonably and in good faith in informing an authority of an instance of fraud which he thinks has been committed would not be held by the court to be in breach of duty to the client even if, an investigation or prosecution having occurred, it were found that there has been no offence.

10. An auditor may need to take legal advice before making a decision on whether the matter should be reported to a proper authority in the public interest.

11 An auditor needs to remember that his decision as to whether to report, and if so to whom, may be called into question at a future date, for example on the basis of

   (a) what he knew at the time;

   (b) what he ought to have known in the course of his audit;

   (c) what he ought to have concluded; and

   (d) what he ought to have done.

An auditor may also wish to consider the possible consequences if financial loss is occasioned as a result of fraud which he suspects (or ought to suspect) has occurred but decides not to report.

12. In addition to the duty of an auditor of entities in regulated industries to report direct to regulators in certain circumstances (see paragraph 1 above), an auditor and others have a statutory duty to take the initiative to disclose to an authorized officer (as defined in the Drug Trafficking (Recovery of Proceeds) Ordinance (DTROP), the Organized and Serious Crimes Ordinance (OSCO) and the United Nations (Anti-Terrorism Measures) Ordinance (UNATMO)) knowledge or suspicion that any property represents

    (a) proceeds of, or was used in connection with, or is intended to be used in connection with, drug trafficking under the DTROP;

    (b) proceeds of, or was used in connection with, or is intended to be used in connection with, an indictable offence under the OSCO ; and

    (c) terrorist property under the UNATMO.

    A failure to disclose in these circumstances is itself an offence. However, under the above legislation, a disclosure by an employee to an appropriate person designated for the purpose, according to the employer's procedures, is regarded as being the same as a disclosure to an authorized officer. It should also be noted that there are other offences under the respective Ordinances, including the offence of "tipping off", and further guidance on these offences and definitions of "authorized officer", "proceeds", etc. described above are provided in Anti-Money Laundering Bulletin (AMLB) 1 "Requirements on Anti-money Laundering, Anti-terrorist Financing and Related Matters" and a supplement to AMLB 1, "Frequently Asked Questions on Suspicious Transaction Reporting" issued by the Hong Kong Institute of Certified Public Accountants.

13. A disclosure made under DTROP or OSCO will not be treated as a breach of contract, any enactment, rule of conduct or other provision restricting disclosure of information and will not render the person making the disclosure liable in damages for any loss arising out of the disclosure.

14. A disclosure made under UNATMO will not be treated as a breach of any restriction upon the disclosure of information imposed by contract or by any enactment, rules of conduct or other provision. The person making the disclosure will not be liable in damages for any loss arising out of the disclosure, or any act done or omitted to be done in relation to the property concerned in consequence of the disclosure.

HKSA 250 (Revised)
Issued June 2017

Effective for audits of financial statements
for periods beginning on or after 15 December 2017

Hong Kong Standard on Auditing 250 (Revised)

Consideration of Laws and Regulations in an Audit of Financial Statements

Hong Kong Institute of
Certified Public Accountants
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HKSA 260 (Revised)

Issued August 2015; revised January 2016, June 2017, January 2019

Effective for audits of financial statements for periods ending on or after 15 December 2016

Hong Kong Standard on Auditing 260 (Revised)

Communication with Those Charged with Governance

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

matters that the auditor is required to communicate does not relieve the auditor of the responsibility to also communicate them. Communication of these matters by management may, however, affect the form or timing of the auditor's communication with those charged with governance.

6. Clear communication of specific matters required to be communicated by HKSAs is an integral part of every audit. HKSAs do not, however, require the auditor to perform procedures specifically to identify any other matters to communicate with those charged with governance.

7. In some jurisdictions, law or regulation may restrict the auditor's communication of certain matters with those charged with governance. Law or regulation may specifically prohibit a communication[1a], or other action, that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act, including alerting the entity, for example, when the auditor is required to report identified or suspected non-compliance with laws and regulations to an appropriate authority pursuant to anti-money laundering legislation.[1b] In these circumstances, the issues considered by the auditor may be complex and the auditor may consider it appropriate to obtain legal advice.

Effective Date

8. This HKSA is effective for audits of financial statements for periods ending on or after 15 December 2016.

Objectives

9. The objectives of the auditor are:
   (a) To communicate clearly with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, and an overview of the planned scope and timing of the audit;
   (b) To obtain from those charged with governance information relevant to the audit;
   (c) To provide those charged with governance with timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process; and
   (d) To promote effective two-way communication between the auditor and those charged with governance.

Definitions

10. For purposes of the HKSAs, the following terms have the meanings attributed below:
    (a) Those charged with governance – The person(s) or organization(s) (e.g., a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager. For discussion of the diversity of governance structures, see paragraphs A1–A8.

[1a] In Hong Kong, section 378 of the Securities and Futures Ordinance imposes a duty of secrecy upon the auditor of a licensed corporation. Application of section 378 will prevent the auditor from communicating certain matters to any parties other than the Securities and Futures Commission except under certain circumstances. Further guidance is set out in PN 820 (Revised), *The Audit of Licensed Corporations and Associated Entities of Intermediaries*.

[1b] Additional guidance is provided in Appendix 4 of HKSA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*.

would not be adequate. Written communications need not include all matters that arose during the course of the audit. (Ref: Para. A46–A48)

20. The auditor shall communicate in writing with those charged with governance regarding auditor independence when required by paragraph 17.

Timing of Communications

21. The auditor shall communicate with those charged with governance on a timely basis. (Ref: Para. A49–A50)

Adequacy of the Communication Process

22. The auditor shall evaluate whether the two-way communication between the auditor and those charged with governance has been adequate for the purpose of the audit. If it has not, the auditor shall evaluate the effect, if any, on the auditor's assessment of the risks of material misstatement and ability to obtain sufficient appropriate audit evidence, and shall take appropriate action. (Ref: Para. A51–A53)

Documentation

23. Where matters required by this HKSA to be communicated are communicated orally, the auditor shall include them in the audit documentation, and when and to whom they were communicated. Where matters have been communicated in writing, the auditor shall retain a copy of the communication as part of the audit documentation.[2] (Ref: Para. A54)

Conformity and Compliance with International Standards on Auditing

24. As of August 2015 (date of issue), this HKSA conforms with International Standard on Auditing (ISA) 260 (Revised), *Communication with Those Charged with Governance*. Compliance with the requirements of this HKSA ensures compliance with ISA 260 (Revised).

25. Additional local guidance is provided in footnotes 1a and 1b.

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Application and Other Explanatory Material

Those Charged with Governance (Ref: Para. 11)

A1. Governance structures vary by jurisdiction and by entity, reflecting influences such as different cultural and legal backgrounds, and size and ownership characteristics. For example:

- In some jurisdictions, a supervisory (wholly or mainly non-executive) board exists that is legally separate from an executive (management) board (a "two-tier board" structure). In other jurisdictions, both the supervisory and executive functions are the legal responsibility of a single, or unitary, board (a "one-tier board" structure).
- In some entities, those charged with governance hold positions that are an integral part of the entity's legal structure, for example, company directors. In others, for example, some government entities, a body that is not part of the entity is charged with governance.

[2] HKSA 230, *Audit Documentation*, paragraphs 8–11, and A6

HKSA 450

Issued July 2009; revised July 2010, August 2015, January 2016, June 2017, January 2019

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

Hong Kong Standard on Auditing 450

Evaluation of Misstatements Identified during the Audit

Hong Kong Institute of
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HONG KONG STANDARD ON AUDITING 450

EVALUATION OF MISSTATEMENTS IDENTIFIED DURING THE AUDIT

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

CONTENTS

Hong Kong Standard on Auditing (HKSA) 450, *Evaluation of Misstatements Identified during the Audit*, should be read in the context of HKSA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing*.

Requirements

Accumulation of Identified Misstatements

5. The auditor shall accumulate misstatements identified during the audit, other than those that are clearly trivial. (Ref: Para. A2-A6)

Consideration of Identified Misstatements as the Audit Progresses

6. The auditor shall determine whether the overall audit strategy and audit plan need to be revised if:

   (a) The nature of identified misstatements and the circumstances of their occurrence indicate that other misstatements may exist that, when aggregated with misstatements accumulated during the audit, could be material; or (Ref: Para. A7)

   (b) The aggregate of misstatements accumulated during the audit approaches materiality determined in accordance with HKSA 320. (Ref: Para. A8)

7. If, at the auditor's request, management has examined a class of transactions, account balance or disclosure and corrected misstatements that were detected, the auditor shall perform additional audit procedures to determine whether misstatements remain. (Ref: Para. A9)

Communication and Correction of Misstatements

8. The auditor shall communicate, unless prohibited by law or regulation, on a timely basis all misstatements accumulated during the audit with the appropriate level of management.[3] The auditor shall request management to correct those misstatements. (Ref: Para. A10-A12)

9. If management refuses to correct some or all of the misstatements communicated by the auditor, the auditor shall obtain an understanding of management's reasons for not making the corrections and shall take that understanding into account when evaluating whether the financial statements as a whole are free from material misstatement. (Ref: Para. A13)

Evaluating the Effect of Uncorrected Misstatements

10. Prior to evaluating the effect of uncorrected misstatements, the auditor shall reassess materiality determined in accordance with HKSA 320 to confirm whether it remains appropriate in the context of the entity's actual financial results. (Ref: Para. A14-A15)

11. The auditor shall determine whether uncorrected misstatements are material, individually or in aggregate. In making this determination, the auditor shall consider:

    (a) The size and nature of the misstatements, both in relation to particular classes of transactions, account balances or disclosures and the financial statements as a whole, and the particular circumstances of their occurrence; and (Ref: Para. A16-A22, A24-A25)

    (b) The effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole. (Ref: Para. A23)

[3] HKSA 260 (Revised), *Communication with Those Charged with Governance*, paragraph 7

Communication with Those Charged with Governance

12. The auditor shall communicate with those charged with governance uncorrected misstatements and the effect that they, individually or in aggregate, may have on the opinion in the auditor's report, unless prohibited by law or regulation.[4] The auditor's communication shall identify material uncorrected misstatements individually. The auditor shall request that uncorrected misstatements be corrected. (Ref: Para. A26-A28)

13. The auditor shall also communicate with those charged with governance the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

Written Representations

14. The auditor shall request a written representation from management and, where appropriate, those charged with governance whether they believe the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole. A summary of such items shall be included in or attached to the written representation. (Ref: Para. A29)

Documentation

15. The auditor shall include in the audit documentation: [5] (Ref: Para. A30)

    (a) The amount below which misstatements would be regarded as clearly trivial (paragraph 5);

    (b) All misstatements accumulated during the audit and whether they have been corrected (paragraphs 5, 8 and 12); and

    (c) The auditor's conclusion as to whether uncorrected misstatements are material, individually or in aggregate, and the basis for that conclusion (paragraph 11).

Conformity and Compliance with International Standards on Auditing

16. As of July 2009 (date of issue), this HKSA conforms with International Standard on Auditing (ISA) 450, *Evaluation of Misstatements Identified during the Audit*. Compliance with the requirements of this HKSA ensures compliance with ISA 450.

17. Additional local guidance is provided in footnote 10a.

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Application and Other Explanatory Material

Definition of Misstatement (Ref: Para. 4(a))

A1. Misstatements may result from:

    (a) An inaccuracy in gathering or processing data from which the financial statements are prepared;

    (b) An omission of an amount or disclosure, including inadequate or incomplete disclosures, and those disclosures required to meet disclosure objectives of certain financial reporting frameworks as applicable;[6]

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4 See footnote 3.

5 HKSA 230, *Audit Documentation*, paragraphs 8-11, and A6

6 For example, Hong Kong Financial Reporting Standard 7 (HKFRS), *Financial Instruments: Disclosures*, paragraph 42H states that "an entity shall disclose any additional information that it considers necessary to meet the disclosure objectives in paragraph …"

A11. In some jurisdictions, law or regulation may restrict the auditor's communication of certain misstatements to management, or others, within the entity. Laws or regulations may specifically prohibit a communication, or other action, that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act, including alerting the entity, for example, when the auditor is required to report identified or suspected non-compliance with law or regulation to an appropriate authority pursuant to anti-money laundering legislation.[10a] In these circumstances, the issues considered by the auditor may be complex and the auditor may consider it appropriate to obtain legal advice.

A12. The correction by management of all misstatements, including those communicated by the auditor, enables management to maintain accurate accounting books and records and reduces the risks of material misstatement of future financial statements because of the cumulative effect of immaterial uncorrected misstatements related to prior periods.

A13. HKSA 700 (Revised) requires the auditor to evaluate whether the financial statements are prepared and presented, in all material respects, in accordance with the requirements of the applicable financial reporting framework. This evaluation includes consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments,[11] which may be affected by the auditor's understanding of management's reasons for not making the corrections.

Evaluating the Effect of Uncorrected Misstatements (Ref: Para. 10-11)

A14. The auditor's determination of materiality in accordance with HKSA 320 is often based on estimates of the entity's financial results, because the actual financial results may not yet be known. Therefore, prior to the auditor's evaluation of the effect of uncorrected misstatements, it may be necessary to revise materiality determined in accordance with HKSA 320 based on the actual financial results.

A15. HKSA 320 explains that, as the audit progresses, materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) is revised in the event of the auditor becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially.[12] Thus, any significant revision is likely to have been made before the auditor evaluates the effect of uncorrected misstatements. However, if the auditor's reassessment of materiality determined in accordance with HKSA 320 (see paragraph 10 of this HKSA) gives rise to a lower amount (or amounts), then performance materiality and the appropriateness of the nature, timing and extent of the further audit procedures are reconsidered so as to obtain sufficient appropriate audit evidence on which to base the audit opinion.

A16. Each individual misstatement of an amount is considered to evaluate its effect on the relevant classes of transactions, account balances or disclosures, including whether the materiality level for that particular class of transactions, account balance or disclosure, if any, has been exceeded.

A17. In addition, each individual misstatement of a qualitative disclosure is considered to evaluate its effect on the relevant disclosure(s), as well as its overall effect on the financial statements as a whole. The determination of whether a misstatement(s) in a qualitative disclosure is material, in the context of the applicable financial reporting framework and the specific circumstances of the entity, is a matter that involves the exercise of professional judgment. Examples where such misstatements may be material include:

[10a] Additional guidance is provided in Appendix 4 of HKSA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*.

[11] HKSA 700 (Revised), paragraph 12

[12] HKSA 320, paragraph 12

HKSA 500

Issued July 2009; revised July 2010, May 2013,

February 2015, August 2015, June 2017, January 2019

Effective for audits of financial statements

for periods beginning on or after 15 December 2009

Hong Kong Standard on Auditing 500

Audit Evidence

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HONG KONG STANDARD ON AUDITING 500

AUDIT EVIDENCE

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

CONTENTS

Hong Kong Standard on Auditing (HKSA) 500, *Audit Evidence*, 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) explains what constitutes audit evidence in an audit of financial statements, and deals with the auditor's responsibility to design and perform audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.

2. This HKSA is applicable to all the audit evidence obtained during the course of the audit. Other HKSAs deal with specific aspects of the audit (for example, HKSA 315 (Revised)[1]), the audit evidence to be obtained in relation to a particular topic (for example, HKSA 570 (Revised)[2]), specific procedures to obtain audit evidence (for example, HKSA 520[3]), and the evaluation of whether sufficient appropriate audit evidence has been obtained (HKSA 200[4] and HKSA 330[5]).

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 is to design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.

Definitions

5. For purposes of the HKSAs, the following terms have the meanings attributed below:

   (a) Accounting records – The records of initial accounting entries and supporting records, such as checks and records of electronic fund transfers; invoices; contracts; the general and subsidiary ledgers, journal entries and other adjustments to the financial statements that are not reflected in journal entries; and records such as work sheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures.

   (b) Appropriateness (of audit evidence) – The measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based.

   (c) Audit evidence – Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and information obtained from other sources.

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[1] HKSA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

[2] HKSA 570 (Revised), *Going Concern*

[3] HKSA 520, *Analytical Procedures*.

[4] HKSA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing*

[5] HKSA 330, *The Auditor's Responses to Assessed Risks*

(d) Management's expert – An individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements.

(e) Sufficiency (of audit evidence) – The measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the auditor's assessment of the risks of material misstatement and also by the quality of such audit evidence.

Requirements

Sufficient Appropriate Audit Evidence

6. The auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence. (Ref: Para. A1-A25)

Information to Be Used as Audit Evidence

7. When designing and performing audit procedures, the auditor shall consider the relevance and reliability of the information to be used as audit evidence. (Ref: Para. A26-A34)

8. If information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes: (Ref: Para. A35-A37)

   (a) Evaluate the competence, capabilities and objectivity of that expert; (Ref: Para. A38-A44)

   (b) Obtain an understanding of the work of that expert; and (Ref: Para. A45-A48)

   (c) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion. (Ref: Para. A49)

9. When using information produced by the entity, the auditor shall evaluate whether the information is sufficiently reliable for the auditor's purposes, including, as necessary in the circumstances:

   (a) Obtaining audit evidence about the accuracy and completeness of the information; and (Ref: Para. A50-A51)

   (b) Evaluating whether the information is sufficiently precise and detailed for the auditor's purposes. (Ref: Para. A52)

Selecting Items for Testing to Obtain Audit Evidence

10. When designing tests of controls and tests of details, the auditor shall determine means of selecting items for testing that are effective in meeting the purpose of the audit procedure. (Ref: Para. A53-A57)

Inconsistency in, or Doubts over Reliability of, Audit Evidence

11. If:

    (a) audit evidence obtained from one source is inconsistent with that obtained from another; or

    (b) the auditor has doubts over the reliability of information to be used as audit evidence,

    the auditor shall determine what modifications or additions to audit procedures are necessary to resolve the matter, and shall consider the effect of the matter, if any, on other aspects of the audit. (Ref: Para. A58)

Conformity and Compliance with International Standards on Auditing

12. As of July 2009 (date of issue), this HKSA conforms with International Standard on Auditing (ISA) 500, *Audit Evidence*. Compliance with the requirements of this HKSA ensures compliance with ISA 500.

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Application and Other Explanatory Material

Sufficient Appropriate Audit Evidence (Ref: Para. 6)

A1. Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources such as previous audits (provided the auditor has determined whether changes have occurred since the previous audit that may affect its relevance to the current audit[6]) or a firm's quality control procedures for client acceptance and continuance. In addition to other sources inside and outside the entity, the entity's accounting records are an important source of audit evidence. Also, information that may be used as audit evidence may have been prepared using the work of a management's expert. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions. In addition, in some cases the absence of information (for example, management's refusal to provide a requested representation) is used by the auditor, and therefore, also constitutes audit evidence.

A2. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Audit procedures to obtain audit evidence can include inspection, observation, confirmation, recalculation, reperformance and analytical procedures, often in some combination, in addition to inquiry. Although inquiry may provide important audit evidence, and may even produce evidence of a misstatement, inquiry alone ordinarily does not provide sufficient audit evidence of the absence of a material misstatement at the assertion level, nor of the operating effectiveness of controls.

A3. As explained in HKSA 200,[7] reasonable assurance is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (that is, the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level.

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[6] HKSA 315 (Revised), paragraph 9

[7] HKSA 200, paragraph 5

A4. The sufficiency and appropriateness of audit evidence are interrelated. Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality.

A5. Appropriateness is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based. The reliability of evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.

A6. HKSA 330 requires the auditor to conclude whether sufficient appropriate audit evidence has been obtained.[8] Whether sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level, and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion, is a matter of professional judgment. HKSA 200 contains discussion of such matters as the nature of audit procedures, the timeliness of financial reporting, and the balance between benefit and cost, which are relevant factors when the auditor exercises professional judgment regarding whether sufficient appropriate audit evidence has been obtained.

Sources of Audit Evidence

A7. Some audit evidence is obtained by performing audit procedures to test the accounting records, for example, through analysis and review, reperforming procedures followed in the financial reporting process, and reconciling related types and applications of the same information. Through the performance of such audit procedures, the auditor may determine that the accounting records are internally consistent and agree to the financial statements.

A8. More assurance is ordinarily obtained from consistent audit evidence obtained from different sources or of a different nature than from items of audit evidence considered individually. For example, corroborating information obtained from a source independent of the entity may increase the assurance the auditor obtains from audit evidence that is generated internally, such as evidence existing within the accounting records, minutes of meetings, or a management representation.

A9. Information from sources independent of the entity that the auditor may use as audit evidence may include confirmations from third parties, analysts' reports, and comparable data about competitors (benchmarking data).

Audit Procedures for Obtaining Audit Evidence

A10. As required by, and explained further in, HKSA 315 (Revised) and HKSA 330, audit evidence to draw reasonable conclusions on which to base the auditor's opinion is obtained by performing:

(a) Risk assessment procedures; and

(b) Further audit procedures, which comprise:

(i) Tests of controls, when required by the HKSAs or when the auditor has chosen to do so; and

[8] HKSA 330, paragraph 26

(ii) Substantive procedures, including tests of details and substantive analytical procedures.

A11. The audit procedures described in paragraphs A14-A25 below may be used as risk assessment procedures, tests of controls or substantive procedures, depending on the context in which they are applied by the auditor. As explained in HKSA 330, audit evidence obtained from previous audits may, in certain circumstances, provide appropriate audit evidence where the auditor performs audit procedures to establish its continuing relevance.[9]

A12. The nature and timing of the audit procedures to be used may be affected by the fact that some of the accounting data and other information may be available only in electronic form or only at certain points or periods in time. For example, source documents, such as purchase orders and invoices, may exist only in electronic form when an entity uses electronic commerce, or may be discarded after scanning when an entity uses image processing systems to facilitate storage and reference.

A13. Certain electronic information may not be retrievable after a specified period of time, for example, if files are changed and if backup files do not exist. Accordingly, the auditor may find it necessary as a result of an entity's data retention policies to request retention of some information for the auditor's review or to perform audit procedures at a time when the information is available.

Inspection

A14. Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset. Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their nature and source and, in the case of internal records and documents, on the effectiveness of the controls over their production. An example of inspection used as a test of controls is inspection of records for evidence of authorization.

A15. Some documents represent direct audit evidence of the existence of an asset, for example, a document constituting a financial instrument such as a stock or bond. Inspection of such documents may not necessarily provide audit evidence about ownership or value. In addition, inspecting an executed contract may provide audit evidence relevant to the entity's application of accounting policies, such as revenue recognition.

A16. Inspection of tangible assets may provide reliable audit evidence with respect to their existence, but not necessarily about the entity's rights and obligations or the valuation of the assets. Inspection of individual inventory items may accompany the observation of inventory counting.

Observation

A17. Observation consists of looking at a process or procedure being performed by others, for example, the auditor's observation of inventory counting by the entity's personnel, or of the performance of control activities. Observation provides audit evidence about the performance of a process or procedure, but is limited to the point in time at which the observation takes place, and by the fact that the act of being observed may affect how the process or procedure is performed. See HKSA 501 for further guidance on observation of the counting of inventory.[10]

[9] HKSA 330, paragraph A35

[10] HKSA 501, *Audit Evidence—Specific Considerations for Selected Items*

External Confirmation

A18. An external confirmation represents audit evidence obtained by the auditor as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium. External confirmation procedures frequently are relevant when addressing assertions associated with certain account balances and their elements. However, external confirmations need not be restricted to account balances only. For example, the auditor may request confirmation of the terms of agreements or transactions an entity has with third parties; the confirmation request may be designed to ask if any modifications have been made to the agreement and, if so, what the relevant details are. External confirmation procedures also are used to obtain audit evidence about the absence of certain conditions, for example, the absence of a "side agreement" that may influence revenue recognition. See HKSA 505 for further guidance.[11]

Recalculation

A19. Recalculation consists of checking the mathematical accuracy of documents or records. Recalculation may be performed manually or electronically.

Reperformance

A20. Reperformance involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control.

Analytical Procedures

A21. Analytical procedures consist of evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount. See HKSA 520 for further guidance.

Inquiry

A22. Inquiry consists of seeking information of knowledgeable persons, both financial and non-financial, within the entity or outside the entity. Inquiry is used extensively throughout the audit in addition to other audit procedures. Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process.

A23. Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence. Alternatively, responses might provide information that differs significantly from other information that the auditor has obtained, for example, information regarding the possibility of management override of controls. In some cases, responses to inquiries provide a basis for the auditor to modify or perform additional audit procedures.

A24. Although corroboration of evidence obtained through inquiry is often of particular importance, in the case of inquiries about management intent, the information available to support management's intent may be limited. In these cases, understanding management's past history of carrying out its stated intentions, management's stated reasons for choosing a

[11] HKSA 505, *External Confirmations*

particular course of action, and management's ability to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry.

A25. In respect of some matters, the auditor may consider it necessary to obtain written representations from management and, where appropriate, those charged with governance to confirm responses to oral inquiries. See HKSA 580 for further guidance.[12]

Information to Be Used as Audit Evidence

Relevance and Reliability (Ref: Para. 7)

A26. As noted in paragraph A1, while audit evidence is primarily obtained from audit procedures performed during the course of the audit, it may also include information obtained from other sources such as, for example, previous audits, in certain circumstances, a firm's quality control procedures for client acceptance and continuance and complying with certain additional responsibilities under law, regulation or relevant ethical requirements (e.g., regarding an entity's non-compliance with laws and regulations). The quality of all audit evidence is affected by the relevance and reliability of the information upon which it is based.

Relevance

A27. Relevance deals with the logical connection with, or bearing upon, the purpose of the audit procedure and, where appropriate, the assertion under consideration. The relevance of information to be used as audit evidence may be affected by the direction of testing. For example, if the purpose of an audit procedure is to test for overstatement in the existence or valuation of accounts payable, testing the recorded accounts payable may be a relevant audit procedure. On the other hand, when testing for understatement in the existence or valuation of accounts payable, testing the recorded accounts payable would not be relevant, but testing such information as subsequent disbursements, unpaid invoices, suppliers' statements, and unmatched receiving reports may be relevant.

A28. A given set of audit procedures may provide audit evidence that is relevant to certain assertions, but not others. For example, inspection of documents related to the collection of receivables after the period end may provide audit evidence regarding existence and valuation, but not necessarily cutoff. Similarly, obtaining audit evidence regarding a particular assertion, for example, the existence of inventory, is not a substitute for obtaining audit evidence regarding another assertion, for example, the valuation of that inventory. On the other hand, audit evidence from different sources or of a different nature may often be relevant to the same assertion.

A29. Tests of controls are designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level. Designing tests of controls to obtain relevant audit evidence includes identifying conditions (characteristics or attributes) that indicate performance of a control, and deviation conditions which indicate departures from adequate performance. The presence or absence of those conditions can then be tested by the auditor.

A30. Substantive procedures are designed to detect material misstatements at the assertion level. They comprise tests of details and substantive analytical procedures. Designing substantive procedures includes identifying conditions relevant to the purpose of the test that constitute a misstatement in the relevant assertion.

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[12] HKSA 580, *Written Representations*

Reliability

A31. The reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its source and its nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance where relevant. Therefore, generalizations about the reliability of various kinds of audit evidence are subject to important exceptions. Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability. For example, information obtained from an independent external source may not be reliable if the source is not knowledgeable, or a management's expert may lack objectivity. While recognizing that exceptions may exist, the following generalizations about the reliability of audit evidence may be useful:

- The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.
- The reliability of audit evidence that is generated internally is increased when the related controls, including those over its preparation and maintenance, imposed by the entity are effective.
- Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).
- Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed).
- Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles, or documents that have been filmed, digitized or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.

A32. HKSA 520 provides further guidance regarding the reliability of data used for purposes of designing analytical procedures as substantive procedures.[13]

A33. HKSA 240 deals with circumstances where the auditor has reason to believe that a document may not be authentic, or may have been modified without that modification having been disclosed to the auditor.[14]

A34. HKSA 250 (Revised)[15] provides further guidance with respect to the auditor complying with any additional responsibilities under law, regulation or relevant ethical requirements regarding an entity's identified or suspected non-compliance with laws and regulations that may provide further information that is relevant to the auditor's work in accordance with HKSAs and evaluating the implications of such non-compliance in relation to other aspects of the audit.

Reliability of Information Produced by a Management's Expert (Ref: Para. 8)

A35. The preparation of an entity's financial statements may require expertise in a field other than accounting or auditing, such as actuarial calculations, valuations, or engineering data. The entity may employ or engage experts in these fields to obtain the needed expertise to prepare the financial statements. Failure to do so when such expertise is necessary increases the risks of material misstatement.

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[13] HKSA 520, paragraph 5(a)

[14] HKSA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, paragraph 13

[15] HKSA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements,* paragraph 9

A36. When information to be used as audit evidence has been prepared using the work of a management's expert, the requirement in paragraph 8 of this HKSA applies. For example, an individual or organization may possess expertise in the application of models to estimate the fair value of securities for which there is no observable market. If the individual or organization applies that expertise in making an estimate which the entity uses in preparing its financial statements, the individual or organization is a management's expert and paragraph 8 applies. If, on the other hand, that individual or organization merely provides price data regarding private transactions not otherwise available to the entity which the entity uses in its own estimation methods, such information, if used as audit evidence, is subject to paragraph 7 of this HKSA, but is not the use of a management's expert by the entity.

A37. The nature, timing and extent of audit procedures in relation to the requirement in paragraph 8 of this HKSA, may be affected by such matters as:

- The nature and complexity of the matter to which the management's expert relates.
- The risks of material misstatement in the matter.
- The availability of alternative sources of audit evidence.
- The nature, scope and objectives of the management's expert's work.
- Whether the management's expert is employed by the entity, or is a party engaged by it to provide relevant services.
- The extent to which management can exercise control or influence over the work of the management's expert.
- Whether the management's expert is subject to technical performance standards or other professional or industry requirements.
- The nature and extent of any controls within the entity over the management's expert's work.
- The auditor's knowledge and experience of the management's expert's field of expertise.
- The auditor's previous experience of the work of that expert.

The Competence, Capabilities, and Objectivity of a Management's Expert (Ref: Para. 8(a))

A38. Competence relates to the nature and level of expertise of the management's expert. Capability relates the ability of the management's expert to exercise that competence in the circumstances. Factors that influence capability may include, for example, geographic location, and the availability of time and resources. Objectivity relates to the possible effects that bias, conflict of interest or the influence of others may have on the professional or business judgment of the management's expert. The competence, capabilities and objectivity of a management's expert, and any controls within the entity over that expert's work, are important factors in relation to the reliability of any information produced by a management's expert.

A39. Information regarding the competence, capabilities and objectivity of a management's expert may come from a variety of sources, such as:

- Personal experience with previous work of that expert.
- Discussions with that expert.
- Discussions with others who are familiar with that expert's work.
- Knowledge of that expert's qualifications, membership of a professional body or industry association, license to practice, or other forms of external recognition.
- Published papers or books written by that expert.
- An auditor's expert, if any, who assists the auditor in obtaining sufficient appropriate audit evidence with respect to information produced by the management's expert.

A40. Matters relevant to evaluating the competence, capabilities and objectivity of a management's expert include whether that expert's work is subject to technical performance standards or other professional or industry requirements, for example, ethical standards and other membership requirements of a professional body or industry association, accreditation standards of a licensing body, or requirements imposed by law or regulation.

A41. Other matters that may be relevant include:

- The relevance of the management's expert's competence to the matter for which that expert's work will be used, including any areas of specialty within that expert's field. For example, a particular actuary may specialize in property and casualty insurance, but have limited expertise regarding pension calculations.
- The management's expert's competence with respect to relevant accounting requirements, for example, knowledge of assumptions and methods, including models where applicable, that are consistent with the applicable financial reporting framework.
- Whether unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures indicate that it may be necessary to reconsider the initial evaluation of the competence, capabilities and objectivity of the management's expert as the audit progresses.

A42. A broad range of circumstances may threaten objectivity, for example, self-interest threats, advocacy threats, familiarity threats, self-review threats and intimidation threats. Safeguards may reduce such threats, and may be created either by external structures (for example, the management's expert's profession, legislation or regulation), or by the management's expert's work environment (for example, quality control policies and procedures).

A43. Although safeguards cannot eliminate all threats to a management's expert's objectivity, threats such as intimidation threats may be of less significance to an expert engaged by the entity than to an expert employed by the entity, and the effectiveness of safeguards such as quality control policies and procedures may be greater. Because the threat to objectivity created by being an employee of the entity will always be present, an expert employed by the entity cannot ordinarily be regarded as being more likely to be objective than other employees of the entity.

A44. When evaluating the objectivity of an expert engaged by the entity, it may be relevant to discuss with management and that expert any interests and relationships that may create threats to the expert's objectivity, and any applicable safeguards, including any professional requirements that apply to the expert; and to evaluate whether the safeguards are adequate. Interests and relationships creating threats may include:

- Financial interests.
- Business and personal relationships.
- Provision of other services.

Obtaining an Understanding of the Work of the Management's Expert (Ref: Para. 8(b))

A45. An understanding of the work of the management's expert includes an understanding of the relevant field of expertise. An understanding of the relevant field of expertise may be obtained in conjunction with the auditor's determination of whether the auditor has the expertise to evaluate the work of the management's expert, or whether the auditor needs an auditor's expert for this purpose.[16]

A46. Aspects of the management's expert's field relevant to the auditor's understanding may include:

- Whether that expert's field has areas of specialty within it that are relevant to the audit.
- Whether any professional or other standards, and regulatory or legal requirements apply.
- What assumptions and methods are used by the management's expert, and whether they are generally accepted within that expert's field and appropriate for financial reporting purposes.
- The nature of internal and external data or information the management's expert uses.

A47. In the case of a management's expert engaged by the entity, there will ordinarily be an engagement letter or other written form of agreement between the entity and that expert. Evaluating that agreement when obtaining an understanding of the work of the management's expert may assist the auditor in determining the appropriateness of the following for the auditor's purposes:

- The nature, scope and objectives of that expert's work;
- The respective roles and responsibilities of management and that expert; and
- The nature, timing and extent of communication between management and that expert, including the form of any report to be provided by that expert.

A48. In the case of a management's expert employed by the entity, it is less likely there will be a written agreement of this kind. Inquiry of the expert and other members of management may be the most appropriate way for the auditor to obtain the necessary understanding.

[16] HKSA 620, *Using the Work of an Auditor's Expert*, paragraph 7

Evaluating the Appropriateness of the Management's Expert's Work (Ref: Para. 8(c))

A49. Considerations when evaluating the appropriateness of the management's expert's work as audit evidence for the relevant assertion may include:

- The relevance and reasonableness of that expert's findings or conclusions, their consistency with other audit evidence, and whether they have been appropriately reflected in the financial statements;
- If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods; and
- If that expert's work involves significant use of source data, the relevance, completeness, and accuracy of that source data.

Information Produced by the Entity and Used for the Auditor's Purposes (Ref: Para. 9(a)-(b))

A50. In order for the auditor to obtain reliable audit evidence, information produced by the entity that is used for performing audit procedures needs to be sufficiently complete and accurate. For example, the effectiveness of auditing revenue by applying standard prices to records of sales volume is affected by the accuracy of the price information and the completeness and accuracy of the sales volume data. Similarly, if the auditor intends to test a population (for example, payments) for a certain characteristic (for example, authorization), the results of the test will be less reliable if the population from which items are selected for testing is not complete.

A51. Obtaining audit evidence about the accuracy and completeness of such information may be performed concurrently with the actual audit procedure applied to the information when obtaining such audit evidence is an integral part of the audit procedure itself. In other situations, the auditor may have obtained audit evidence of the accuracy and completeness of such information by testing controls over the preparation and maintenance of the information. In some situations, however, the auditor may determine that additional audit procedures are needed.

A52. In some cases, the auditor may intend to use information produced by the entity for other audit purposes. For example, the auditor may intend to make use of the entity's performance measures for the purpose of analytical procedures, or to make use of the entity's information produced for monitoring activities, such as reports of the internal audit function. In such cases, the appropriateness of the audit evidence obtained is affected by whether the information is sufficiently precise or detailed for the auditor's purposes. For example, performance measures used by management may not be precise enough to detect material misstatements.

Selecting Items for Testing to Obtain Audit Evidence (Ref: Para. 10)

A53. An effective test provides appropriate audit evidence to an extent that, taken with other audit evidence obtained or to be obtained, will be sufficient for the auditor's purposes. In selecting items for testing, the auditor is required by paragraph 7 to determine the relevance and reliability of information to be used as audit evidence; the other aspect of effectiveness (sufficiency) is an important consideration in selecting items to test. The means available to the auditor for selecting items for testing are:

(a) Selecting all items (100% examination);

(b) Selecting specific items; and

(c) Audit sampling.

The application of any one or combination of these means may be appropriate depending on the particular circumstances, for example, the risks of material misstatement related to the assertion being tested, and the practicality and efficiency of the different means.

Selecting All Items

A54. The auditor may decide that it will be most appropriate to examine the entire population of items that make up a class of transactions or account balance (or a stratum within that population). 100% examination is unlikely in the case of tests of controls; however, it is more common for tests of details. 100% examination may be appropriate when, for example:

- The population constitutes a small number of large value items;
- There is a significant risk and other means do not provide sufficient appropriate audit evidence; or
- The repetitive nature of a calculation or other process performed automatically by an information system makes a 100% examination cost effective.

Selecting Specific Items

A55. The auditor may decide to select specific items from a population. In making this decision, factors that may be relevant include the auditor's understanding of the entity, the assessed risks of material misstatement, and the characteristics of the population being tested. The judgmental selection of specific items is subject to non-sampling risk. Specific items selected may include:

- *High value or key items*. The auditor may decide to select specific items within a population because they are of high value, or exhibit some other characteristic, for example, items that are suspicious, unusual, particularly risk-prone or that have a history of error.
- *All items over a certain amount*. The auditor may decide to examine items whose recorded values exceed a certain amount so as to verify a large proportion of the total amount of a class of transactions or account balance.
- *Items to obtain information*. The auditor may examine items to obtain information about matters such as the nature of the entity or the nature of transactions.

A56. While selective examination of specific items from a class of transactions or account balance will often be an efficient means of obtaining audit evidence, it does not constitute audit sampling. The results of audit procedures applied to items selected in this way cannot be projected to the entire population; accordingly, selective examination of specific items does not provide audit evidence concerning the remainder of the population.

Audit Sampling

A57. Audit sampling is designed to enable conclusions to be drawn about an entire population on the basis of testing a sample drawn from it. Audit sampling is discussed in HKSA 530.[17]

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[17] HKSA 530, *Audit Sampling*

Inconsistency in, or Doubts over Reliability of, Audit Evidence (Ref: Para. 11)

A58. Obtaining audit evidence from different sources or of a different nature may indicate that an individual item of audit evidence is not reliable, such as when audit evidence obtained from one source is inconsistent with that obtained from another. This may be the case when, for example, responses to inquiries of management, internal auditors, and others are inconsistent, or when responses to inquiries of those charged with governance made to corroborate the responses to inquiries of management are inconsistent with the response by management. HKSA 230 includes a specific documentation requirement if the auditor identified information that is inconsistent with the auditor's final conclusion regarding a significant matter.[18]

[18] HKSA 230, *Audit Documentation*, paragraph 11

HKSRE 2400 (Revised)
Issued December 2012; revised January 2019

Hong Kong Standard on Review Engagements 2400 (Revised)

Engagements to Review Historical Financial Statements

Hong Kong Institute of Certified Public Accountants
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HONG KONG STANDARD ON REVIEW ENGAGEMENTS 2400 (REVISED)

ENGAGEMENTS TO REVIEW HISTORICAL FINANCIAL STATEMENTS

(Effective for reviews of financial statements for periods ending on or after 31 December 2013)

CONTENTS

Hong Kong Standard on Review Engagements (HKSRE) 2400 (Revised), *Engagements to Review Historical Financial Statements*, should be read in conjunction with the *Preface to the Hong Kong Standards on Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements*.

Introduction

Scope of this HKSRE

1. This Hong Kong Standard on Review Engagements (HKSRE) deals with: (Ref: Para. A1)

    (a) The practitioner's responsibilities when engaged to perform a review of historical financial statements, when the practitioner is not the auditor of the entity's financial statements; and

    (b) The form and content of the practitioner's report on the financial statements.

2. This HKSRE does not address a review of an entity's financial statements or interim financial information performed by a practitioner who is the independent auditor of the entity's financial statements. (Ref: Para. A2)

3. This HKSRE is to be applied, adapted as necessary, to reviews of other historical financial information. Limited assurance engagements other than reviews of historical financial information are performed under HKSAE 3000 (Revised).[1]

Relationship with HKSQC 1[2]

4. Quality control systems, policies and procedures are the responsibility of the firm. HKSQC 1 applies to firms of professional accountants in respect of a firm's engagements to review financial statements.[3] The provisions of this HKSRE regarding quality control at the level of individual review engagements are premised on the basis that the firm is subject to HKSQC 1 or requirements that are at least as demanding. (Ref: Para. A3–A5)

The Engagement to Review Historical Financial Statements

5. The review of historical financial statements is a limited assurance engagement, as described in the *Hong Kong Framework for Assurance Engagements* (the Assurance Framework).[4] (Ref: Para. A6–A7)

6. In a review of financial statements, the practitioner expresses a conclusion that is designed to enhance the degree of confidence of intended users regarding the preparation of an entity's financial statements in accordance with an applicable financial reporting framework. The practitioner's conclusion is based on the practitioner obtaining limited assurance. The practitioner's report includes a description of the nature of a review engagement as context for the readers of the report to be able to understand the conclusion.

7. The practitioner performs primarily inquiry and analytical procedures to obtain sufficient appropriate evidence as the basis for a conclusion on the financial statements as a whole, expressed in accordance with the requirements of this HKSRE.

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[1] Hong Kong Standard on Assurance Engagements (HKSAE) 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*

[2] Hong Kong Standard on Quality Control (HKSQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

[3] HKSQC 1, paragraph 4

[4] Assurance Framework, paragraphs 7 and 11

8. If the practitioner becomes aware of a matter that causes the practitioner to believe the financial statements may be materially misstated, the practitioner designs and performs additional procedures, as the practitioner considers necessary in the circumstances, to be able to conclude on the financial statements in accordance with this HKSRE.

Authority of this HKSRE

9. This HKSRE contains the objectives of the practitioner in following the HKSRE which provide the context in which the requirements of this HKSRE are set, and are intended to assist the practitioner in understanding what needs to be accomplished in a review engagement.

10. The HKSRE contains requirements, expressed using "shall," that are designed to enable the practitioner to meet the stated objectives.

11. In addition, this HKSRE contains introductory material, definitions, and application and other explanatory material, that provide context relevant to a proper understanding of the HKSRE.

12. The application and other explanatory material provides further explanation of the requirements and guidance for carrying them out. While such guidance does not itself impose a requirement, it is relevant to the proper application of the requirements. The application and other explanatory material may also provide background information on matters addressed in this HKSRE that assists in the application of the requirements.

Effective Date

13. This HKSRE is effective for reviews of financial statements for periods ending on or after 31 December 2013.

Objectives

14. The practitioner's objectives in a review of financial statements under this HKSRE are to:

    (a) Obtain limited assurance, primarily by performing inquiry and analytical procedures, about whether the financial statements as a whole are free from material misstatement, thereby enabling the practitioner to express a conclusion on whether anything has come to the practitioner's attention that causes the practitioner to believe the financial statements are not prepared, in all material respects, in accordance with an applicable financial reporting framework; and

    (b) Report on the financial statements as a whole and communicate, as required by this HKSRE.

15. In all cases when limited assurance cannot be obtained and a qualified conclusion in the practitioner's report is insufficient in the circumstances, this HKSRE requires that the practitioner either disclaim a conclusion in the report issued for the engagement or, where appropriate, withdraw from the engagement if withdrawal is possible under applicable law or regulation. (Ref. Para. A8–A10, A115–A116)

Definitions

16. The Glossary of Terms[5] (the Glossary) includes the terms defined in this HKSRE as well as descriptions of other terms used in this HKSRE, to assist in consistent application and interpretation. For example, the terms "management" and "those charged with governance" used throughout this HKSRE are as defined in the Glossary. (Ref: Para. A11–A12)

17. For purposes of this HKSRE, the following terms have the meanings attributed below:

   (a) *Analytical procedures*—Evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

   (b) *Engagement risk*—The risk that the practitioner expresses an inappropriate conclusion when the financial statements are materially misstated.

   (c) *General purpose financial statements*—Financial statements prepared in accordance with a general purpose framework.

   (d) *General purpose framework*—A financial reporting framework designed to meet the common financial needs of a wide range of users. The financial reporting framework may be a fair presentation framework or a compliance framework.

   (e) *Inquiry*—Inquiry consists of seeking information of knowledgeable persons from within or outside the entity.

   (f) *Limited assurance*—The level of assurance obtained where engagement risk is reduced to a level that is acceptable in the circumstances of the engagement, but where that risk is greater than for a reasonable assurance engagement, as the basis for expressing a conclusion in accordance with this HKSRE. The combination of the nature, timing and extent of evidence gathering procedures is at least sufficient for the practitioner to obtain a meaningful level of assurance. To be meaningful, the level of assurance obtained by the practitioner is likely to enhance the intended users' confidence about the financial statements. (Ref: Para. A13)

   (g) *Practitioner*—A professional accountant in public practice. The term includes the engagement partner or other members of the engagement team, or, as applicable, the firm. Where this HKSRE expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the term "engagement partner" rather than "practitioner" is used. "Engagement partner" and "firm" are to be read as referring to their public sector equivalents where relevant.

   (h) *Professional judgment*—The application of relevant training, knowledge and experience, within the context provided by assurance, accounting and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the review engagement.

5 The Glossary of Terms Relating to Hong Kong Standards on Quality Control, Auditing, Review, Other Assurance and Related Services issued by the HKICPA

(i) *Relevant ethical requirements*—Ethical requirements the engagement team is subject to when undertaking review engagements. These requirements ordinarily comprise Parts A, B and D of the HKICPA's *Code of Ethics for Professional Accountants* (the Code), together with national requirements that are more restrictive.

(j) *Special purpose financial statements*—Financial statements prepared in accordance with a special purpose framework.

(k) *Special purpose framework*—A financial reporting framework designed to meet the financial information needs of specific users. The financial reporting framework may be a fair presentation framework or a compliance framework.

Requirements

Conduct of a Review Engagement in Accordance with this HKSRE

18. The practitioner shall have an understanding of the entire text of this HKSRE, including its application and other explanatory material, to understand its objectives and to apply its requirements properly. (Ref: Para. A14)

Complying with Relevant Requirements

19. The practitioner shall comply with each requirement of this HKSRE, unless a requirement is not relevant to the review engagement. A requirement is relevant to the review engagement when the circumstances addressed by the requirement exist.

20. The practitioner shall not represent compliance with this HKSRE in the practitioner's report unless the practitioner has complied with all the requirements of this HKSRE relevant to the review engagement.

Ethical Requirements

21. The practitioner shall comply with relevant ethical requirements, including those pertaining to independence. (Ref: Para. A15–A16)

Professional Skepticism and Professional Judgment

22. The practitioner shall plan and perform the engagement with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated. (Ref: Para. A17–A20)

23. The practitioner shall exercise professional judgment in conducting a review engagement. (Ref: Para. A21–A25)

Engagement Level Quality Control

24. The engagement partner shall possess competence in assurance skills and techniques, and competence in financial reporting, appropriate to the engagement circumstances. (Ref: Para. A26)

25. The engagement partner shall take responsibility for: (Ref: Para. A27–A30)

    (a) The overall quality of each review engagement to which that partner is assigned;

    (b) The direction, supervision, planning and performance of the review engagement in compliance with professional standards and applicable legal and regulatory requirements; (Ref: Para. A31)

    (c) The practitioner's report being appropriate in the circumstances; and

    (d) The engagement being performed in accordance with the firm's quality control policies, including the following:

        (i) Being satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and engagements have been followed, and that conclusions reached are appropriate, including considering whether there is information that would lead the engagement partner to conclude that management lacks integrity; (Ref: Para. A32–A33)

        (ii) Being satisfied that the engagement team collectively has the appropriate competence and capabilities, including assurance skills and techniques and expertise in financial reporting, to:

            a. Perform the review engagement in accordance with professional standards and applicable legal and regulatory requirements; and

            b. Enable a report that is appropriate in the circumstances to be issued; and

        (iii) Taking responsibility for appropriate engagement documentation being maintained.

Relevant Considerations after Engagement Acceptance

26. If the engagement partner obtains information that would have caused the firm to decline the engagement had that information been available earlier, the engagement partner shall communicate that information promptly to the firm, so that the firm and the engagement partner can take the necessary action.

Compliance with Relevant Ethical Requirements

27. Throughout the engagement, the engagement partner shall remain alert, through observation and making inquiries as necessary, for evidence of non-compliance with relevant ethical requirements by members of the engagement team. If matters come to the engagement partner's attention through the firm's system of quality control or otherwise that indicate that members of the engagement team have not complied with relevant ethical requirements, the engagement partner, in consultation with others in the firm, shall determine the appropriate action.

Monitoring

28. An effective system of quality control for a firm includes a monitoring process designed to provide the firm with reasonable assurance that the firm's policies and procedures relating to the system of quality control are relevant, adequate and operate effectively. The engagement partner shall consider the results of the firm's monitoring process as evidenced in the latest information circulated by the firm and, if applicable, other network firms and whether deficiencies noted in that information may affect the review engagement.

Acceptance and Continuance of Client Relationships and Review Engagements

Factors Affecting Acceptance and Continuance of Client Relationships and Review Engagements

29. Unless required by law or regulation, the practitioner shall not accept a review engagement if: (Ref: Para. A34–A35)

    (a) The practitioner is not satisfied:

        (i) That there is a rational purpose for the engagement; or (Ref: Para. A36)

        (ii) That a review engagement would be appropriate in the circumstances; (Ref: Para. A37)

    (b) The practitioner has reason to believe that relevant ethical requirements, including independence, will not be satisfied;

    (c) The practitioner's preliminary understanding of the engagement circumstances indicates that information needed to perform the review engagement is likely to be unavailable or unreliable; (Ref: Para. A38)

    (d) The practitioner has cause to doubt management's integrity such that it is likely to affect proper performance of the review; or (Ref: Para. A37(b))

    (e) Management or those charged with governance impose a limitation on the scope of the practitioner's work in the terms of a proposed review engagement such that the practitioner believes the limitation will result in the practitioner disclaiming a conclusion on the financial statements.

Preconditions for Accepting a Review Engagement

30. Prior to accepting a review engagement, the practitioner shall: (Ref: Para. A39)

    (a) Determine whether the financial reporting framework applied in the preparation of the financial statements is acceptable including, in the case of special purpose financial statements, obtaining an understanding of the purpose for which the financial statements are prepared and of the intended users; and (Ref: Para. A40–A46)

    (b) Obtain the agreement of management that it acknowledges and understands its responsibilities: (Ref: Para. A47–A50)

        (i) For preparation of the financial statements in accordance with the applicable financial reporting framework, including, where relevant, their fair presentation;

        (ii) For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and

(iii) To provide the practitioner with:

a. Access to all information of which management is aware that is relevant to the preparation of the financial statements, such as records, documentation and other matters;

b. Additional information that the practitioner may request from management for the purpose of the review; and

c. Unrestricted access to persons within the entity from whom the practitioner determines it necessary to obtain evidence.

31. If the practitioner is not satisfied as to any of the matters set out above as preconditions for accepting a review engagement, the practitioner shall discuss the matter with management or those charged with governance. If changes cannot be made to satisfy the practitioner as to those matters, the practitioner shall not accept the proposed engagement unless required by law or regulation to do so. However, an engagement conducted under such circumstances does not comply with this HKSRE. Accordingly, the practitioner shall not include any reference within the practitioner's report to the review having been conducted in accordance with this HKSRE.

32. If it is discovered after the engagement has been accepted that the practitioner is not satisfied as to any of the above preconditions, the practitioner shall discuss the matter with management or those charged with governance, and shall determine:

(a) Whether the matter can be resolved;

(b) Whether it is appropriate to continue with the engagement; and

(c) Whether and, if so, how to communicate the matter in the practitioner's report.

Additional Considerations When the Wording of the Practitioner's Report Is Prescribed by Law or Regulation

33. The practitioner's report issued for the review engagement shall refer to this HKSRE only if the report complies with the requirements of paragraph 86.

34. In some cases, when the review is performed pursuant to applicable law or regulation of a jurisdiction, the relevant law or regulation may prescribe the layout or wording of the practitioner's report in a form or in terms that are significantly different from the requirements of this HKSRE. In those circumstances, the practitioner shall evaluate whether users might misunderstand the assurance obtained from the review of the financial statements and, if so, whether additional explanation in the practitioner's report can mitigate possible misunderstanding. (Ref: Para. A51, A148)

35. If the practitioner concludes that additional explanation in the practitioner's report cannot mitigate possible misunderstanding, the practitioner shall not accept the review engagement unless required by law or regulation to do so. A review conducted in accordance with such law or regulation does not comply with this HKSRE. Accordingly, the practitioner shall not include any reference within the practitioner's report to the review having been conducted in accordance with this HKSRE. (Ref: Para. A51, A148)

Agreeing the Terms of Engagement

36. The practitioner shall agree the terms of the engagement with management or those charged with governance, as appropriate, prior to performing the engagement.

37. The agreed terms of engagement shall be recorded in an engagement letter or other suitable form of written agreement, and shall include: (Ref: Para. A52–A54, A56)

(a) The intended use and distribution of the financial statements, and any restrictions on use or distribution where applicable;

(b) Identification of the applicable financial reporting framework;

(c) The objective and scope of the review engagement;

(d) The responsibilities of the practitioner;

(e) The responsibilities of management, including those in paragraph 30(b); (Ref: Para. A47–A50, A55)

(f) A statement that the engagement is not an audit, and that the practitioner will not express an audit opinion on the financial statements; and

(g) Reference to the expected form and content of the report to be issued by the practitioner, and a statement that there may be circumstances in which the report may differ from its expected form and content.

Recurring Engagements

38. On recurring review engagements, the practitioner shall evaluate whether circumstances, including changes in the engagement acceptance considerations, require the terms of engagement to be revised and whether there is a need to remind management or those charged with governance, as appropriate, of the existing terms of engagement. (Ref: Para. A57)

Acceptance of a Change in the Terms of the Review Engagement

39. The practitioner shall not agree to a change in the terms of the engagement where there is no reasonable justification for doing so. (Ref: Para. A58–A60)

40. If, prior to completing the review engagement, the practitioner is requested to change the engagement to an engagement for which no assurance is obtained, the practitioner shall determine whether there is reasonable justification for doing so. (Ref: Para. A61–A62)

41. If the terms of engagement are changed during the course of the engagement, the practitioner and management or those charged with governance, as appropriate, shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.

Communication with Management and Those Charged with Governance

42. The practitioner shall communicate with management or those charged with governance, as appropriate, on a timely basis during the course of the review engagement, all matters concerning the review engagement that, in the practitioner's professional judgment, are of sufficient importance to merit the attention of management or those charged with governance, as appropriate. (Ref: Para. A63–A69)

Performing the Engagement

Materiality in a Review of Financial Statements

43. The practitioner shall determine materiality for the financial statements as a whole, and apply this materiality in designing the procedures and in evaluating the results obtained from those procedures. (Ref: Para. A70–A73)

44. The practitioner shall revise materiality for the financial statements as a whole in the event of becoming aware of information during the review that would have caused the practitioner to have determined a different amount initially. (Ref. Para. A74)

The Practitioner's Understanding

45. The practitioner shall obtain an understanding of the entity and its environment, and the applicable financial reporting framework, to identify areas in the financial statements where material misstatements are likely to arise and thereby provide a basis for designing procedures to address those areas. (Ref: Para. A75–A77)

46. The practitioner's understanding shall include the following: (Ref: Para. A78, A87, A90)

    (a) Relevant industry, regulatory, and other external factors including the applicable financial reporting framework;

    (b) The nature of the entity, including:

        (i) Its operations;

        (ii) Its ownership and governance structure;

        (iii) The types of investments that the entity is making and plans to make;

        (iv) The way that the entity is structured and how it is financed; and

        (v) The entity's objectives and strategies;

    (c) The entity's accounting systems and accounting records; and

    (d) The entity's selection and application of accounting policies.

Designing and Performing Procedures

47. In obtaining sufficient appropriate evidence as the basis for a conclusion on the financial statements as a whole, the practitioner shall design and perform inquiry and analytical procedures: (Ref: Para. A79–A83, A87, A90)

    (a) To address all material items in the financial statements, including disclosures; and

    (b) To focus on addressing areas in the financial statements where material misstatements are likely to arise.

48. The practitioner's inquiries of management and others within the entity, as appropriate, shall include the following: (Ref: Para. A84–A88)

   (a) How management makes the significant accounting estimates required under the applicable financial reporting framework;

   (b) The identification of related parties and related party transactions, including the purpose of those transactions;

   (c) Whether there are significant, unusual or complex transactions, events or matters that have affected or may affect the entity's financial statements, including:

      (i) Significant changes in the entity's business activities or operations;

      (ii) Significant changes to the terms of contracts that materially affect the entity's financial statements, including terms of finance and debt contracts or covenants;

      (iii) Significant journal entries or other adjustments to the financial statements;

      (iv) Significant transactions occurring or recognized near the end of the reporting period;

      (v) The status of any uncorrected misstatements identified during previous engagements; and

      (vi) Effects or possible implications for the entity of transactions or relationships with related parties;

   (d) The existence of any actual, suspected or alleged:

      (i) Fraud or illegal acts affecting the entity; and

      (ii) Non-compliance with provisions of laws and regulations that are generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements, such as tax and pension laws and regulations;

   (e) Whether management has identified and addressed events occurring between the date of the financial statements and the date of the practitioner's report that require adjustment of, or disclosure in, the financial statements;

   (f) The basis for management's assessment of the entity's ability to continue as a going concern; (Ref: Para. A89)

   (g) Whether there are events or conditions that appear to cast doubt on the entity's ability to continue as a going concern;

   (h) Material commitments, contractual obligations or contingencies that have affected or may affect the entity's financial statements, including disclosures; and

   (i) Material non-monetary transactions or transactions for no consideration in the financial reporting period under consideration.

49. In designing analytical procedures, the practitioner shall consider whether the data from the entity's accounting system and accounting records are adequate for the purpose of performing the analytical procedures. (Ref: Para. A90–A92)

Procedures to Address Specific Circumstances

Related parties

50. During the review, the practitioner shall remain alert for arrangements or information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the practitioner.

51. If the practitioner identifies significant transactions outside the entity's normal course of business in the course of performing the review, the practitioner shall inquire of management about:

    (a) The nature of those transactions;

    (b) Whether related parties could be involved; and

    (c) The business rationale (or lack thereof) of those transactions.

Fraud and non-compliance with laws and regulations

52. When there is an indication that fraud or non-compliance with laws and regulations, or suspected fraud or non-compliance with laws and regulations, has occurred in the entity, the practitioner shall:

    (a) Communicate that matter, unless prohibited by law or regulation, with the appropriate level of management or those charged with governance as appropriate; (Ref: Para. A93)

    (b) Request management's assessment of the effect(s), if any, on the financial statements;

    (c) Consider the effect, if any, of management's assessment of the effects of identified or suspected fraud or non-compliance with laws and regulations communicated to the practitioner on the practitioner's conclusion on the financial statements and on the practitioner's report; and

    (d) Determine whether law, regulation or relevant ethical requirements: (Ref: Para. A94-A98)

        (i) Require the practitioner to report to an appropriate authority outside the entity.

        (ii) Establish responsibilities under which reporting to an appropriate authority outside the entity may be appropriate in the circumstances.

Going concern

53. A review of financial statements includes consideration of the entity's ability to continue as a going concern. In considering management's assessment of the entity's ability to continue as a going concern, the practitioner shall cover the same period as that used by management to make its assessment as required by the applicable financial reporting framework, or by law or regulation where a longer period is specified.

54. If, during the performance of the review, the practitioner becomes aware of events or conditions that may cast significant doubt about the entity's ability to continue as a going concern, the practitioner shall: (Ref: Para. A99)

    (a) Inquire of management about plans for future actions affecting the entity's ability to continue as a going concern and about the feasibility of those plans, and also whether management believes the outcome of those plans will improve the situation regarding the entity's ability to continue as a going concern;

(b) Evaluate the results of those inquiries, to consider whether management's responses provide a sufficient basis to:

(i) Continue to present the financial statements on the going concern basis if the applicable financial reporting framework includes the assumption of an entity's continuance as a going concern; or

(ii) Conclude whether the financial statements are materially misstated, or are otherwise misleading regarding the entity's ability to continue as a going concern; and

(c) Consider management's responses in light of all relevant information of which the practitioner is aware as a result of the review.

Use of work performed by others

55. In performing the review, it may be necessary for the practitioner to use work performed by other practitioners, or the work of an individual or organization possessing expertise in a field other than accounting or assurance. If the practitioner uses work performed by another practitioner or an expert in the course of performing the review, the practitioner shall take appropriate steps to be satisfied that the work performed is adequate for the practitioner's purposes. (Ref: Para. A80)

Reconciling the Financial Statements to the Underlying Accounting Records

56. The practitioner shall obtain evidence that the financial statements agree with, or reconcile to, the entity's underlying accounting records. (Ref: Para. A100)

Additional Procedures When the Practitioner Becomes Aware that the Financial Statements May Be Materially Misstated

57. If the practitioner becomes aware of a matter(s) that causes the practitioner to believe the financial statements may be materially misstated, the practitioner shall design and perform additional procedures sufficient to enable the practitioner to: (Ref: Para. A101–A105)

(a) Conclude that the matter(s) is not likely to cause the financial statements as a whole to be materially misstated; or

(b) Determine that the matter(s) causes the financial statements as a whole to be materially misstated.

Subsequent Events

58. If the practitioner becomes aware of events occurring between the date of the financial statements and the date of the practitioner's report that require adjustment of, or disclosure in, the financial statements, the practitioner shall request management to correct those misstatements.

59. The practitioner has no obligation to perform any procedures regarding the financial statements after the date of the practitioner's report. However, if, after the date of the practitioner's report but before the date the financial statements are issued, a fact becomes known to the practitioner that, had it been known to the practitioner at the date of the practitioner's report, may have caused the practitioner to amend the report, the practitioner shall:

(a) Discuss the matter with management or those charged with governance, as appropriate;

(b) Determine whether the financial statements need amendment; and

(c) If so, inquire how management intends to address the matter in the financial statements.

60. If management does not amend the financial statements in circumstances where the practitioner believes they need to be amended, and the practitioner's report has already been provided to the entity, the practitioner shall notify management and those charged with governance not to issue the financial statements to third parties before the necessary amendments have been made. If the financial statements are nevertheless subsequently issued without the necessary amendments, the practitioner shall take appropriate action to seek to prevent reliance on the practitioner's report.

Written Representations

61. The practitioner shall request management to provide a written representation that management has fulfilled its responsibilities described in the agreed terms of engagement. The written representation shall include that: (Ref: Para. A106–A108)

(a) Management has fulfilled its responsibility for the preparation of financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation, and has provided the practitioner with all relevant information and access to information as agreed in the terms of the engagement; and

(b) All transactions have been recorded and are reflected in the financial statements.

If law or regulation requires management to make written public statements about its responsibilities, and the practitioner determines that such statements provide some or all of the representations required by subparagraphs (a)–(b), the relevant matters covered by such statements need not be included in the written representation.

62. The practitioner shall also request management's written representations that management has disclosed to the practitioner: (Ref: Para. A107)

(a) The identity of the entity's related parties and all the related party relationships and transactions of which management is aware;

(b) Significant facts relating to any frauds or suspected frauds known to management that may have affected the entity;

(c) Known actual or possible non-compliance with laws and regulations for which the effects of non-compliance affect the entity's financial statements;

(d) All information relevant to use of the going concern assumption in the financial statements;

(e) That all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure, have been adjusted or disclosed;

(f) Material commitments, contractual obligations or contingencies that have affected or may affect the entity's financial statements, including disclosures; and

(g) Material non-monetary transactions or transactions for no consideration undertaken by the entity in the financial reporting period under consideration.

63. If management does not provide one or more of the requested written representations, the practitioner shall: (Ref: Para. A106)

(a) Discuss the matter with management and those charged with governance, as appropriate;

(b) Re-evaluate the integrity of management, and evaluate the effect that this may have on the reliability of representations (oral or written) and evidence in general; and

(c) Take appropriate actions, including determining the possible effect on the conclusion in the practitioner's report in accordance with this HKSRE.

64. The practitioner shall disclaim a conclusion on the financial statements, or withdraw from the engagement if withdrawal is possible under applicable law or regulation, as appropriate, if:

(a) The practitioner concludes that there is sufficient doubt about the integrity of management such that the written representations are not reliable; or

(b) Management does not provide the required representations required by paragraph 61.

Date of and Period(s) Covered by Written Representations

65. The date of the written representations shall be as near as practicable to, but not after, the date of the practitioner's report. The written representations shall be for all financial statements and period(s) referred to in the practitioner's report.

Evaluating Evidence Obtained from the Procedures Performed

66. The practitioner shall evaluate whether sufficient appropriate evidence has been obtained from the procedures performed and, if not, the practitioner shall perform other procedures judged by the practitioner to be necessary in the circumstances to be able to form a conclusion on the financial statements. (Ref: Para. A109)

67. If the practitioner is not able to obtain sufficient appropriate evidence to form a conclusion, the practitioner shall discuss with management and those charged with governance, as appropriate, the effects such limitations have on the scope of the review. (Ref: Para. A110–A111)

Evaluating the Effect on the Practitioner's Report

68. The practitioner shall evaluate the evidence obtained from the procedures performed to determine the effect on the practitioner's report. (Ref: Para. A103)

Forming the Practitioner's Conclusion on the Financial Statements

Consideration of the Applicable Financial Reporting Framework in Relation to the Financial Statements

69. In forming the conclusion on the financial statements, the practitioner shall:

    (a) Evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework; (Ref: Para. A112–A113)

    (b) Consider whether, in the context of the requirements of the applicable financial reporting framework and the results of procedures performed:

        (i) The terminology used in the financial statements, including the title of each financial statement, is appropriate;

        (ii) The financial statements adequately disclose the significant accounting policies selected and applied;

        (iii) The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;

        (iv) Accounting estimates made by management appear reasonable;

        (v) The information presented in the financial statements appears relevant, reliable, comparable, and understandable; and

        (vi) The financial statements provide adequate disclosures to enable the intended users to understand the effects of material transactions and events on the information conveyed in the financial statements. (Ref: Para. A114–A116)

70. The practitioner shall consider the impact of:

    (a) Uncorrected misstatements identified during the review, and in the previous year's review of the entity's financial statements, on the financial statements as a whole; and

    (b) Qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments. (Ref: Para. A117–A118)

71. If the financial statements are prepared using a fair presentation framework, the practitioner's consideration shall also include: (Ref: Para. A115)

    (a) The overall presentation, structure and content of the financial statements in accordance with the applicable framework; and

    (b) Whether the financial statements, including the related notes, appear to represent the underlying transactions and events in a manner that achieves fair presentation or gives a true and fair view, as appropriate, in the context of the financial statements as a whole.

Form of the Conclusion

72. The practitioner's conclusion on the financial statements, whether unmodified or modified, shall be expressed in the appropriate form in the context of the financial reporting framework applied in the financial statements.

Unmodified Conclusion

73. The practitioner shall express an unmodified conclusion in the practitioner's report on the financial statements as a whole when the practitioner has obtained limited assurance to be able to conclude that nothing has come to the practitioner's attention that causes the practitioner to believe that the financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework.

74. When the practitioner expresses an unmodified conclusion, the practitioner shall, unless otherwise required by law or regulation, use one of the following phrases, as appropriate: (Ref: Para. A119-A120)

    (a) "Based on our review, nothing has come to our attention that causes us to believe that the financial statements do not present fairly, in all material respects (or do not give a true and fair view), in accordance with the applicable financial reporting framework," (for financial statements prepared using a fair presentation framework); or

    (b) "Based on our review, nothing has come to our attention that causes us to believe that the financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework," (for financial statements prepared using a compliance framework).

Modified Conclusion

75. The practitioner shall express a modified conclusion in the practitioner's report on the financial statements as a whole when:

    (a) The practitioner determines, based on the procedures performed and the evidence obtained, that the financial statements are materially misstated; or

    (b) The practitioner is unable to obtain sufficient appropriate evidence in relation to one or more items in the financial statements that are material in relation to the financial statements as a whole.

76. When the practitioner modifies the conclusion expressed on the financial statements, the practitioner shall:

    (a) Use the heading "Qualified Conclusion," "Adverse Conclusion" or "Disclaimer of Conclusion," as appropriate, for the conclusion paragraph in the practitioner's report; and

    (b) Provide a description of the matter giving rise to the modification, under an appropriate heading (for example, "Basis for Qualified Conclusion," "Basis for Adverse Conclusion" or "Basis for Disclaimer of Conclusion," as appropriate), in a separate paragraph in the practitioner's report immediately before the conclusion paragraph (referred to as the basis for conclusion paragraph).

Financial statements are materially misstated

77. If the practitioner determines that the financial statements are materially misstated, the practitioner shall express:

    (a) A qualified conclusion, when the practitioner concludes that the effects of the matter(s) giving rise to the modification are material, but not pervasive to the financial statements; or

    (b) An adverse conclusion, when the effects of the matter(s) giving rise to the modification are both material and pervasive to the financial statements.

78. When the practitioner expresses a qualified conclusion on the financial statements because of a material misstatement, the practitioner shall, unless otherwise required by law or regulation, use one of the following phrases, as appropriate:

    (a) "Based on our review, except for the effects of the matter(s) described in the Basis for Qualified Conclusion paragraph, nothing has come to our attention that causes us to believe that the financial statements do not present fairly, in all material respects (or do not give a true and fair view), … in accordance with the applicable financial reporting framework," (for financial statements prepared using a fair presentation framework); or

    (b) "Based on our review, except for the effects of the matter(s) described in the Basis for Qualified Conclusion paragraph, nothing has come to our attention that causes us to believe that the financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework," (for financial statements prepared using a compliance framework).

79. When the practitioner expresses an adverse conclusion on the financial statements, the practitioner shall, unless otherwise required by law or regulation, use one of the following phrases, as appropriate:

    (a) "Based on our review, due to the significance of the matter(s) described in the Basis for Adverse Conclusion paragraph, the financial statements do not present fairly, in all material respects (or do not give a true and fair view), … in accordance with the applicable financial reporting framework," (for financial statements prepared using a fair presentation framework); or

    (b) "Based on our review, due to the significance of the matter(s) described in the Basis for Adverse Conclusion paragraph, the financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework," (for financial statements prepared using a compliance framework).

80. In the basis for conclusion paragraph, in relation to material misstatements that give rise to either a qualified conclusion or an adverse conclusion, the practitioner shall:

    (a) Describe and quantify the financial effects of the misstatement if the material misstatement relates to specific amounts in the financial statements (including quantitative disclosures), unless impracticable, in which case the practitioner shall so state;

    (b) Explain how disclosures are misstated if the material misstatement relates to narrative disclosures; or

(c) Describe the nature of omitted information if the material misstatement relates to the non-disclosure of information required to be disclosed. Unless prohibited by law or regulation, the practitioner shall include the omitted disclosures where practicable to do so.

Inability to obtain sufficient appropriate evidence

81. If the practitioner is unable to form a conclusion on the financial statements due to inability to obtain sufficient appropriate evidence, the practitioner shall:

(a) Express a qualified conclusion if the practitioner concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive; or

(b) Disclaim a conclusion if the practitioner concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

82. The practitioner shall withdraw from the engagement if the following conditions are present: (Ref: Para. A121–A123)

(a) Due to a limitation on the scope of the review imposed by management after the practitioner has accepted the engagement, the practitioner is unable to obtain sufficient appropriate evidence to form a conclusion on the financial statements;

(b) The practitioner has determined that the possible effects on the financial statements of undetected misstatements are material and pervasive; and

(c) Withdrawal is possible under applicable law or regulation.

83. When the practitioner expresses a qualified conclusion on the financial statements due to inability to obtain sufficient appropriate evidence, the practitioner shall, unless otherwise required by law or regulation, use one of the following phrases, as appropriate:

(a) "Based on our review, except for the possible effects of the matter(s) described in the Basis for Qualified Conclusion paragraph, nothing has come to our attention that causes us to believe that the financial statements do not present fairly, in all material respects (or do not give a true and fair view), … in accordance with the applicable financial reporting framework," (for financial statements prepared using a fair presentation framework); or

(b) "Based on our review, except for the possible effects of the matter(s) described in the Basis for Qualified Conclusion paragraph, nothing has come to our attention that causes us to believe that the financial statements are not prepared, in all material respects, in accordance with the applicable financial reporting framework," (for financial statements prepared using a compliance framework).

84. When disclaiming a conclusion on the financial statements the practitioner shall state in the conclusion paragraph that:

(a) Due to the significance of the matter(s) described in the Basis for Disclaimer of Conclusion paragraph, the practitioner is unable to obtain sufficient appropriate evidence to form a conclusion on the financial statements; and

(b) Accordingly, the practitioner does not express a conclusion on the financial statements.

85. In the basis for conclusion paragraph, in relation to either the qualified conclusion due to inability to obtain sufficient appropriate evidence or when the practitioner disclaims a conclusion, the practitioner shall include the reason(s) for the inability to obtain sufficient appropriate evidence.

The Practitioner's Report

86. The practitioner's report for the review engagement shall be in writing, and shall contain the following elements: (Ref: Para. A124–A127, A148, A150)

(a) A title, which shall clearly indicate that it is the report of an independent practitioner for a review engagement;

(b) The addressee(s), as required by the circumstances of the engagement;

(c) An introductory paragraph that:

(i) Identifies the financial statements reviewed, including identification of the title of each of the statements contained in the set of financial statements and the date and period covered by each financial statement;

(ii) Refers to the summary of significant accounting policies and other explanatory information; and

(iii) States that the financial statements have been reviewed;

(d) A description of the responsibility of management for the preparation of the financial statements, including an explanation that management is responsible for: (Ref: Para. A128–A131)

(i) Their preparation in accordance with the applicable financial reporting framework including, where relevant, their fair presentation;

(ii) Such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error;

(e) If the financial statements are special purpose financial statements:

(i) A description of the purpose for which the financial statements are prepared and, if necessary, the intended users, or reference to a note in the special purpose financial statements that contains that information; and

(ii) If management has a choice of financial reporting frameworks in the preparation of such financial statements, a reference within the explanation of management's responsibility for the financial statements to management's responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances;

(f) A description of the practitioner's responsibility to express a conclusion on the financial statements including reference to this HKSRE and, where relevant, applicable law or regulation; (Ref: Para. A132–133, A149)

(g) A description of a review of financial statements and its limitations, and the following statements: (Ref: Para. A134)

(i) A review engagement under this HKSRE is a limited assurance engagement;

(ii) The practitioner performs procedures, primarily consisting of making inquiries of management and others within the entity, as appropriate, and applying analytical procedures, and evaluates the evidence obtained; and

(iii) The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with Hong Kong Standards on Auditing (HKSAs), and, accordingly, the practitioner does not express an audit opinion on the financial statements;

(h) A paragraph under the heading "Conclusion" that contains:

(i) The practitioner's conclusion on the financial statements as a whole in accordance with paragraphs 72–85, as appropriate; and

(ii) A reference to the applicable financial reporting framework used to prepare the financial statements, including identification of the jurisdiction of origin of the financial reporting framework that is not Hong Kong Financial Reporting Standards or Hong Kong Financial Reporting Standard for Private Entities issued by the Hong Kong Institute of Certified Public Accountants; (Ref: Para. A135–A136)

(i) When the practitioner's conclusion on the financial statements is modified:

(i) A paragraph under the appropriate heading that contains the practitioner's modified conclusion in accordance with paragraphs 72 and 75–85, as appropriate; and

(ii) A paragraph, under an appropriate heading, that provides a description of the matter(s) giving rise to the modification; (Ref: Para. A137)

(j) A reference to the practitioner's obligation under this HKSRE to comply with relevant ethical requirements;

(k) The date of the practitioner's report; (Ref: Para. A144–A147)

(l) The practitioner's signature; and (Ref: Para. A138)

(m) The location in the jurisdiction where the practitioner practices.

Emphasis of Matter and Other Matter Paragraphs in the Practitioner's Report

Emphasis of Matter Paragraphs

87. The practitioner may consider it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the practitioner's judgment, is of such importance that it is fundamental to users' understanding of the financial statements. In such cases, the practitioner shall include an Emphasis of Matter paragraph in the practitioner's report, provided the practitioner has obtained sufficient appropriate evidence to conclude that the matter is not likely to be materially misstated as presented in the financial statements. Such paragraph shall refer only to information presented or disclosed in the financial statements.

88. The practitioner's report on special purpose financial statements shall include an Emphasis of Matter paragraph alerting users of the practitioner's report that the financial statements are prepared in accordance with a special purpose framework and that, as a result, the financial statements may not be suitable for another purpose. (Ref: Para. A139–A140)

89. The practitioner shall include an Emphasis of Matter paragraph immediately after the paragraph that contains the practitioner's conclusion on the financial statements under the heading "Emphasis of Matter," or other appropriate heading.

Other Matter Paragraphs

90. If the practitioner considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the practitioner's judgment, is relevant to users' understanding of the review, the practitioner's responsibilities or the practitioner's report and this is not prohibited by law or regulation, the practitioner shall do so in a paragraph in the practitioner's report with the heading "Other Matter" or other appropriate heading.

Other Reporting Responsibilities

91. A practitioner may be requested to address other reporting responsibilities in the practitioner's report on the financial statements that are in addition to the practitioner's responsibilities under this HKSRE to report on the financial statements. In such situations, those other reporting responsibilities shall be addressed by the practitioner in a separate section in the practitioner's report headed "Report on Other Legal and Regulatory Requirements," or otherwise as appropriate to the content of the section, following the section of the report headed "Report on the Financial Statements."(Ref: Para. A141–A143)

Date of the Practitioner's Report

92. The practitioner shall date the report no earlier than the date on which the practitioner has obtained sufficient appropriate evidence as the basis for the practitioner's conclusion on the financial statements, including being satisfied that: (Ref: Para. A144–A147)

    (a) All the statements that comprise the financial statements under the applicable financial reporting framework, including the related notes where applicable, have been prepared; and

    (b) Those with the recognized authority have asserted that they have taken responsibility for those financial statements.

Documentation

93. The preparation of documentation for the review provides evidence that the review was performed in accordance with this HKSRE, and legal and regulatory requirements where relevant, and a sufficient and appropriate record of the basis for the practitioner's report. The practitioner shall document the following aspects of the engagement in a timely manner, sufficient to enable an experienced practitioner, having no previous connection with the engagement, to understand: (Ref: Para. A151)

    (a) The nature, timing, and extent of the procedures performed to comply with this HKSRE and applicable legal and regulatory requirements;

(b) Results obtained from the procedures, and the practitioner's conclusions formed on the basis of those results; and

(c) Significant matters arising during the engagement, the practitioner's conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

94. In documenting the nature, timing and extent of procedures performed as required in this HKSRE, the practitioner shall record:

(a) Who performed the work and the date such work was completed; and

(b) Who reviewed the work performed for the purpose of quality control for the engagement, and the date and extent of the review.

95. The practitioner shall also document discussions with management, those charged with governance, and others as relevant to the performance of the review of significant matters arising during the engagement, including the nature of those matters.

96. If, in the course of the engagement, the practitioner identified information that is inconsistent with the practitioner's findings regarding significant matters affecting the financial statements, the practitioner shall document how the inconsistency was addressed.

Conformity and Compliance with International Standards on Review Engagements

97. As of December 2012 *(date of issue)*, this HKSRE conforms with International Standard on Review Engagements (ISRE) 2400 (Revised), "Engagements to Review Historical Financial Statements" except that a reference to the IESBA's Code of Ethics for Professional Accountants is replaced by the HKICPA's Code of Ethics for Professional Accountants. With the exception of the foregoing difference, compliance with the requirements of this HKSRE ensures compliance with ISRE 2400 (Revised).

98. Additional local guidance is provided in footnote 11a, 13a of Appendix 1 and footnotes 20a, 22a, 24a, 27a, 29a, 30a and 31a of Appendix 2.

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Application and Other Explanatory Material

Scope of this HKSRE (Ref: Para. 1–2)

A1. In performing a review of financial statements, the practitioner may be required to comply with legal or regulatory requirements, which may differ from the requirements established in this HKSRE. While the practitioner may find aspects of this HKSRE helpful in these circumstances, it is the responsibility of the practitioner to ensure compliance with all relevant legal, regulatory and professional obligations.

Reviews of Financial Information of Components in the Context of an Audit of the Financial Statements of a Group of Entities

A2. Review engagements in accordance with this HKSRE may be requested for component entities by the auditor of the financial statements of a group of entities.[6] Such a review engagement performed in accordance with this HKSRE may be accompanied by a request from the group auditor to undertake additional work or procedures as needed in the circumstances of the group audit engagement.

Relationship with HKSQC 1 (Ref: Para. 4)

A3. HKSQC 1 deals with the firm's responsibilities to establish and maintain its system of quality control for assurance engagements, including review engagements. Those responsibilities are directed at establishing the firm's:

- Quality control system; and
- Related policies designed to achieve the objective of the quality control system and the firm's procedures to implement and monitor compliance with those policies, including policies and procedures that address each of the following elements:
    - Leadership responsibilities for quality within the firm.
    - Relevant ethical requirements.
    - Acceptance and continuance of client relationships and specific engagements.
    - Human resources.
    - Engagement performance.
    - Monitoring.

A4. Under HKSQC 1, the firm has an obligation to establish and maintain a system of quality control to provide it with reasonable assurance that:

(a) The firm and its personnel comply with professional standards and applicable legal and regulatory requirements; and

(b) Reports issued by the firm or engagement partners are appropriate in the circumstances.[7]

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6 HKSA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors*, paragraph A52

7 HKSQC 1, paragraph 11

A5. National requirements that deal with the firm's responsibilities to establish and maintain a system of quality control are at least as demanding as HKSQC 1 when they address all the elements referred to in paragraph A3, and impose obligations on the firm that achieve the aims of the requirements set out in HKSQC 1.

The Engagement to Review Historical Financial Statements (Ref: Para. 5–8, 14)

A6. Reviews of financial statements may be performed for a wide range of entities that vary by type or size, or by the level of complexity in their financial reporting. In some jurisdictions, the review of financial statements of certain types of entity may also be the subject of local laws or regulations and related reporting requirements.

A7. Reviews may be performed in a variety of circumstances. For example, they may be required for entities that are exempt from requirements specified in law or regulation for mandatory audit. Reviews may also be requested on a voluntary basis, such as in connection with financial reporting undertaken for arrangements under the terms of a private contract, or to support funding arrangements.

Objectives (Ref: Para. 15)

A8. This HKSRE requires the practitioner to disclaim a conclusion on the financial statements if:

(a) The practitioner issues a report, or is required to issue a report for the engagement; and

(b) The practitioner is unable to form a conclusion on the financial statements due to inability to obtain sufficient appropriate evidence, and the practitioner concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

A9. The situation of being unable to obtain sufficient appropriate evidence in a review engagement (referred to as a scope limitation) may arise from:

(a) Circumstances beyond the control of the entity;

(b) Circumstances relating to the nature or timing of the practitioner's work; or

(c) Limitations imposed by management or those charged with governance of the entity.

A10. This HKSRE sets out requirements and guidance for the practitioner when the practitioner encounters a scope limitation, either prior to accepting a review engagement, or during the engagement.

Definitions (Ref: Para. 16)

Use of the Terms "Management" and "Those Charged with Governance"

A11. The respective responsibilities of management and those charged with governance will differ between jurisdictions, and between entities of various types. These differences affect the way the practitioner applies the requirements of this HKSRE in relation to management or those charged with governance Accordingly, the phrase "management and, where appropriate, those charged with governance" used in various places throughout this HKSRE is intended to alert the practitioner to the fact that different entity environments may have different management and governance structures and arrangements.

A12. Various responsibilities relating to preparation of financial information and external financial reporting will fall to either management or those charged with governance according to factors such as:

- The resources and structure of the entity; and

- The respective roles of management and those charged with governance within the entity as set out in relevant law or regulation or, if the entity is not regulated, in any formal governance or accountability arrangements established for the entity (for example, as recorded in contracts, a constitution or other type of establishment documents of the entity).

For example, in small entities there is often no separation of the management and governance roles. In larger entities, management is often responsible for execution of the business or activities of the entity and reporting thereon, while those charged with governance oversee management. In some jurisdictions, the responsibility for preparation of financial statements for an entity is the legal responsibility of those charged with governance, and in some other jurisdictions it is a management responsibility.

Limited Assurance – Use of the Term Sufficient Appropriate Evidence (Ref: Para. 17(f))

A13. Sufficient appropriate evidence is required to obtain limited assurance to support the practitioner's conclusion. Evidence is cumulative in nature and is primarily obtained from the procedures performed during the course of the review.

Conduct of a Review Engagement in Accordance with this HKSRE (Ref: Para. 18)

A14. This HKSRE does not override laws and regulations that govern a review of financial statements. In the event that those laws and regulations differ from the requirements of this HKSRE, a review conducted only in accordance with laws and regulations will not automatically comply with this HKSRE.

Ethical Requirements (Ref: Para. 21)

A15. Part A of the Code establishes the fundamental principles of professional ethics practitioners must comply with, and provides a conceptual framework for applying those principles. The fundamental principles are:

(a) Integrity;

(b) Objectivity;

(c) Professional competence and due care;

(d) Confidentiality; and

(e) Professional behavior.

Parts B and D of the Code illustrates how the conceptual framework is to be applied in specific situations. In complying with the Code, threats to the practitioner's compliance with relevant ethical requirements are required to be identified and appropriately addressed.

A16. In the case of an engagement to review financial statements, the Code requires that the practitioner be independent of the entity whose financial statements are reviewed. The Code describes independence as comprising both independence of mind and independence in appearance. The practitioner's independence safeguards the practitioner's ability to form a conclusion without being affected by influences that might otherwise compromise that conclusion. Independence enhances the practitioner's ability to act with integrity, to be objective and to maintain an attitude of professional skepticism.

Professional Skepticism and Professional Judgment

Professional Skepticism (Ref: Para. 22)

A17. Professional skepticism is necessary for the critical assessment of evidence in a review. This includes questioning inconsistencies and investigating contradictory evidence, and questioning the reliability of responses to inquiries and other information obtained from management and those charged with governance. It also includes consideration of the sufficiency and appropriateness of evidence obtained in the light of the engagement circumstances.

A18. Professional skepticism includes being alert to, for example:

- Evidence that is inconsistent with other evidence obtained.
- Information that calls into question the reliability of documents and responses to inquiries to be used as evidence.
- Conditions that may indicate possible fraud.
- Any other circumstances that suggest the need for additional procedures.

A19. Maintaining professional skepticism throughout the review is necessary if the practitioner is to reduce the risks of:

- Overlooking unusual circumstances.
- Over-generalizing when drawing conclusions from evidence obtained.
- Using inappropriate assumptions in determining the nature, timing, and extent of the procedures performed in the review, and evaluating the results thereof.

A20. The practitioner cannot be expected to disregard past experience of the honesty and integrity of the entity's management and those charged with governance. Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the practitioner of the need to maintain professional skepticism or allow the practitioner to be satisfied with evidence that is inadequate for the purpose of the review.

Professional Judgment (Ref: Para. 23)

A21. Professional judgment is essential to the proper conduct of a review engagement. This is because interpretation of relevant ethical requirements and the requirements of this HKSRE, and the need for informed decisions throughout the performance of a review engagement, require the application of relevant knowledge and experience to the facts and circumstances of the engagement. Professional judgment is necessary, in particular:

- Regarding decisions about materiality, and the nature, timing, and extent of procedures used to meet the requirements of this HKSRE, and to gather evidence.

- When evaluating whether the evidence obtained from the procedures performed reduces the engagement risk to a level that is acceptable in the engagement circumstances.

- When considering management's judgments in applying the entity's applicable financial reporting framework.

- When forming the conclusion on the financial statements based on the evidence obtained, including considering the reasonableness of the estimates made by management in preparing the financial statements.

A22. The distinguishing feature of the professional judgment expected of the practitioner is that it is exercised by a practitioner whose training, knowledge and experience, including in the use of assurance skills and techniques, have assisted in developing the necessary competencies to achieve reasonable judgments. Consultation on difficult or contentious matters during the course of the engagement, both within the engagement team and between the engagement team and others at the appropriate level within or outside the firm, assists the practitioner in making informed and reasonable judgments.

A23. The exercise of professional judgment in individual engagements is based on the facts and circumstances that are known by the practitioner throughout the engagement, including:

- Knowledge acquired from engagements carried out with respect to the entity's financial statements in prior periods, where applicable.

- The practitioner's understanding of the entity and its environment, including its accounting system, and of the application of the applicable financial reporting framework in the entity's industry.

- The extent to which the preparation and presentation of the financial statements require the exercise of management judgment.

A24. Professional judgment can be evaluated based on whether the judgment reached reflects a competent application of assurance and accounting principles, and is appropriate in the light of, and consistent with, the facts and circumstances that were known to the practitioner up to the date of the practitioner's report.

A25. Professional judgment needs to be exercised throughout the engagement. It also needs to be appropriately documented in accordance with the requirements of this HKSRE. Professional judgment is not to be used as the justification for decisions that are not otherwise supported by the facts and circumstances of the engagement, or the evidence obtained.

Engagement Level Quality Control (Ref: Para. 24–25)

A26. Assurance skills and techniques include:

- Applying professional skepticism and professional judgment to planning and performing an assurance engagement, including obtaining and evaluating evidence;

- Understanding information systems and the role and limitations of internal control;

- Linking the consideration of materiality and engagement risks to the nature, timing and extent of procedures for the review;

- Applying procedures as appropriate to the review engagement, which may include other types of procedures in addition to inquiry and analytical procedures (such as inspection, re-calculation, re-performance, observation and confirmation);
- Systematic documentation practices; and
- Application of skills and practices relevant for writing reports for assurance engagements.

A27. Within the context of the firm's system of quality control, engagement teams have a responsibility to implement quality control procedures applicable to the engagement, and provide the firm with relevant information to enable the functioning of that part of the firm's system of quality control relating to independence.

A28. The actions of the engagement partner and appropriate messages to the other members of the engagement team, in the context of the engagement partner taking responsibility for the overall quality on each review engagement, emphasize the fact that quality is essential in performing a review engagement, and the importance to the quality of the review engagement of:

(a) Performing work that complies with professional standards and regulatory and legal requirements.

(b) Complying with the firm's quality control policies and procedures as applicable.

(c) Issuing a report for the engagement that is appropriate in the circumstances.

(d) The engagement team's ability to raise concerns without fear of reprisals.

A29. Unless information provided by the firm or other parties suggests otherwise, the engagement team is entitled to rely on the firm's system of quality control. For example, the engagement team may rely on the firm's system of quality control in relation to:

- 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.
- Adherence to regulatory and legal requirements through the monitoring process.

In considering deficiencies identified in the firm's system of quality control that may affect the review engagement, the engagement partner may consider measures taken by the firm to rectify those deficiencies.

A30. A deficiency in the firm's system of quality control does not necessarily indicate that a review engagement was not performed in accordance with professional standards and applicable legal and regulatory requirements, or that the practitioner's report was not appropriate.

Assignment of Engagement Teams (Ref: Para. 25(b))

A31. When considering the appropriate competence and capabilities expected of the engagement team as a whole, the engagement partner may take into consideration such matters as the team's:

- Understanding of, and practical experience with, review engagements of a similar nature and complexity through appropriate training and participation.
- Understanding of professional standards and applicable legal and regulatory requirements.
- Technical expertise, including expertise with relevant information technology and specialized areas of accounting or assurance.
- Knowledge of relevant industries in which the client operates.
- Ability to apply professional judgment.
- Understanding of the firm's quality control policies and procedures.

Acceptance and Continuance of Client Relationships and Review Engagements (Ref: Para. 25(d)(i))

A32. HKSQC 1 requires the firm to obtain information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. Information that assists the engagement partner in determining whether acceptance and continuance of client relationships and review engagements are appropriate may include information concerning:

- The integrity of the principal owners, key management and those charged with governance; and
- Significant matters that have arisen during the current or a previous review engagement, and their implications for continuing the relationship.

A33. If the engagement partner has cause to doubt management's integrity to a degree that is likely to affect proper performance of the review, it is not appropriate under this HKSRE to accept the engagement, unless required by law or regulation, as doing so may lead to the practitioner being associated with the entity's financial statements in an inappropriate manner.

Acceptance and Continuance of Client Relationships and Review Engagements (Ref: Para. 29)

A34. The practitioner's consideration of engagement continuance, and relevant ethical requirements, including independence, occurs throughout the engagement, as conditions and changes in circumstances occur. Performing initial procedures on engagement continuance and evaluation of relevant ethical requirements (including independence) at the beginning of an engagement informs the practitioner's decisions and actions prior to the performance of other significant activities for the engagement.

Factors Affecting Acceptance and Continuance of Client Relationships and Review Engagements (Ref: Para. 29)

A35. Assurance engagements may only be accepted when the engagement exhibits certain characteristics[8] that are conducive to achieving the practitioner's objectives specified for the engagement.

Rational Purpose (Ref: Para. 29(a)(i))

A36. It may be unlikely that there is a rational purpose for the engagement if, for example:

(a) There is a significant limitation on the scope of the practitioner's work;

(b) The practitioner suspects the engaging party intends to associate the practitioner's name with the financial statements in an inappropriate manner; or

(c) The engagement is intended to meet compliance requirements of relevant law or regulation and such law or regulation requires the financial statements to be audited.

Review Engagement Is Appropriate (Ref: Para. 29(a)(ii))

A37. When the practitioner's preliminary understanding of the engagement circumstances indicates that accepting a review engagement would not be appropriate, the practitioner may consider recommending that another type of engagement be undertaken. Depending on the circumstances, the practitioner may, for example, believe that performance of an audit engagement would be more appropriate than a review. In other cases, if the engagement circumstances preclude performance of an assurance engagement, the practitioner may recommend a compilation engagement, or other accounting services engagement, as appropriate.

Information Needed to Perform the Review Engagement (Ref: Para. 29(c))

A38. An example of where the practitioner may have cause to doubt that the information needed to perform the review will be available or reliable is where the accounting records necessary for purposes of performing analytical procedures are suspected to be substantially inaccurate or incomplete. This consideration is not directed at the need that sometimes arises in the course of a review engagement to assist management by recommending adjusting entries required to finalize the financial statements prepared by management.

Preconditions for Accepting a Review Engagement (Ref: Para. 30)

A39. This HKSRE also requires the practitioner to ascertain certain matters, upon which it is necessary for the practitioner and the entity's management to agree, and which are within the control of the entity, prior to the practitioner accepting the engagement.

The Applicable Financial Reporting Framework (Ref: Para. 30(a))

A40. A condition for acceptance of an assurance engagement is that the criteria[9] referred to in the definition of an assurance engagement are suitable and available to intended users.[10] For purposes of this HKSRE, the applicable financial reporting framework provides the criteria the practitioner uses to review the financial statements including, where relevant, the fair presentation of the financial statements. Some financial reporting frameworks are fair presentation frameworks, while others are compliance frameworks. The requirements of the

8 Assurance Framework, paragraph 17

9 Assurance Framework, paragraph 34

10 Assurance Framework, paragraph 17(b)(ii)

applicable financial reporting framework determine the form and content of the financial statements, including what constitutes a complete set of financial statements.

Acceptability of the applicable financial reporting framework

A41. Without an acceptable financial reporting framework, management does not have an appropriate basis for the preparation of the financial statements and the practitioner does not have suitable criteria for the review of the financial statements.

A42. The practitioner's determination of the acceptability of the financial reporting framework applied in the financial statements is made in the context of the practitioner's understanding of who the intended users of the financial statements are. The intended users are the person, persons or group of persons for whom the practitioner prepares the report. The practitioner may not be able to identify all those who will read the assurance report, particularly where there is a large number of people who have access to it.

A43. In many cases, in the absence of any indications to the contrary, the practitioner may presume that the applicable financial reporting framework is acceptable (for example, a financial reporting framework that is prescribed by law or regulation in a jurisdiction to be used in the preparation of general purpose financial statements for certain types of entities).

A44. Factors that are relevant to the practitioner's determination of the acceptability of the financial reporting framework to be applied in the preparation of the financial statements include:

- The nature of the entity (for example, whether it is a business enterprise, a public sector entity or a not-for-profit organization).
- The purpose of the financial statements (for example, whether they are prepared to meet the common financial information needs of a wide range of users or the financial information needs of specific users).
- The nature of the financial statements (for example, whether the financial statements are a complete set of financial statements or a single financial statement).
- Whether the applicable financial reporting framework is prescribed in relevant law or regulation.

A45. If the financial reporting framework used to prepare the financial statements is not acceptable in view of the purpose of the financial statements and management will not agree to use of a financial reporting framework that is acceptable in the practitioner's view, the practitioner is required under this HKSRE to decline the engagement.

A46. Deficiencies in the applicable financial reporting framework that indicate that the framework is not acceptable may be encountered after the review engagement has been accepted. When use of that financial reporting framework is not prescribed by law or regulation, management may decide to adopt another framework that is acceptable. When management does so, the practitioner is required under this HKSRE to agree the new terms of the review engagement with management to reflect the change in the applicable financial reporting framework.

Responsibilities of Management and Those Charged with Governance (Ref: Para. 30(b), 37(e))

A47. The financial statements subject to review are those of the entity, prepared by management of the entity with oversight from those charged with governance. This HKSRE does not impose responsibilities on management and those charged with governance, nor does it override laws and regulations that govern their respective responsibilities. However, a review in accordance with this HKSRE is conducted on the premise that management, and those charged with governance as appropriate, have acknowledged certain responsibilities that are fundamental to the conduct of the review. The review of the financial statements does not relieve management and those charged with governance of their responsibilities.

A48. As part of its responsibility for the preparation of the financial statements, management is required to exercise judgment in making accounting estimates that are reasonable in the circumstances, and to select and apply appropriate accounting policies. These judgments are made in the context of the applicable financial reporting framework.

A49. Because of the significance of the preconditions for undertaking a review of financial statements, the practitioner is required under this HKSRE to obtain the agreement of management that it understands its responsibilities before accepting a review engagement. The practitioner may obtain management's agreement either orally or in writing. However, management's agreement is subsequently recorded within the written terms of the engagement.

A50. If management, and those charged with governance where appropriate, do not or will not acknowledge their responsibilities in relation to the financial statements, it is not appropriate to accept the engagement unless law or regulation requires the practitioner to do so. In circumstances where the practitioner is required to accept the review engagement, the practitioner may need to explain to management and those charged with governance, where different, the importance of these matters and the implications for the engagement.

Additional Considerations When the Wording of the Practitioner's Report Is Prescribed by Law or Regulation (Ref: Para. 34–*35*)

A51. This HKSRE requires the practitioner to not represent compliance with this HKSRE unless the practitioner has complied with all the requirements of this HKSRE that are relevant to the review engagement. Law or regulation may prescribe matters in relation to an engagement that would ordinarily cause the practitioner to decline the engagement were it possible to do so, for example, if:

- The practitioner considers that the financial reporting framework prescribed by law or regulation is not acceptable; or
- The prescribed layout or wording of the practitioner's report is in a form or in terms that are significantly different from the layout or wording required by this HKSRE.

Under this HKSRE, a review conducted in these situations does not comply with this HKSRE and the practitioner cannot represent compliance with this HKSRE in the report issued for the engagement. Notwithstanding that the practitioner is not permitted to represent compliance with this HKSRE, the practitioner is, however, encouraged to apply this HKSRE, including the reporting requirements, to the extent practicable. When appropriate to avoid misunderstanding, the practitioner may consider including a statement in the report that the review is not conducted in accordance with this HKSRE.

Agreeing the Terms of Engagement

Engagement Letter or Other Form of Written Agreement (Ref: Para. 37)

A52. It is in the interests of both management and those charged with governance, and the practitioner, that the practitioner sends an engagement letter prior to performing the review engagement, to help avoid misunderstandings with respect to the engagement.

Form and content of the engagement letter

A53. The form and content of the engagement letter may vary for each engagement. In addition to including the matters required by this HKSRE, an engagement letter may make reference to, for example:

- Arrangements concerning the involvement of other practitioners and experts in the review engagement.
- Arrangements to be made with the predecessor practitioner, if any, in the case of an initial engagement.
- The fact that a review engagement will not satisfy any statutory or third party requirements for an audit.
- The expectation that management will provide written representations to the practitioner.
- The agreement of management to inform the practitioner of facts that may affect the financial statements of which management may become aware during the period from the date of the practitioner's report to the date the financial statements are issued.
- A request for management to acknowledge receipt of the engagement letter and to agree to the terms of the engagement outlined therein.

Review of components of groups of entities

A54. The auditor of the financial statements of a group of entities may request that a practitioner perform a review of the financial information of a component entity of the group. Depending on the instructions of the group auditor, a review of the financial information of a component may be performed in accordance with this HKSRE. The group auditor may also specify additional procedures to supplement the work done for the review performed under this HKSRE. Where the practitioner conducting the review is the auditor of the component entity's financial statements, the review is not performed in accordance with this HKSRE.

Responsibilities of management prescribed by law or regulation (Ref: Para. 37(e))

A55. If, in the circumstances of the engagement, the practitioner concludes that it is not necessary to record certain terms of the engagement in an engagement letter, the practitioner is still required to seek the written agreement from management, and those charged with governance where appropriate, required under this HKSRE that they acknowledge and understand their responsibilities set out in this HKSRE. This written agreement may use the wording of the law or regulation if the law or regulation establishes responsibilities for management that are equivalent in effect to those described in this HKSRE.

Illustrative Engagement Letter (Ref: Para. 37)

A56. An illustrative engagement letter for a review engagement is set out in Appendix 1 to this HKSRE.

Recurring Engagements (Ref: Para. 38)

A57. The practitioner may decide not to send a new engagement letter or other written agreement each period. However, the following factors may indicate that it is appropriate to revise the terms of the review engagement or to remind management and those charged with governance, as appropriate, of the existing terms of the engagement:

- Any indication that management misunderstands the objective and scope of the review.
- Any revised or special terms of the engagement.
- A recent change of senior management of the entity.
- A significant change in ownership of the entity.
- A significant change in nature or size of the entity's business.
- A change in legal or regulatory requirements affecting the entity.
- A change in the applicable financial reporting framework.

Acceptance of a Change in the Terms of the Review Engagement

Request to Change the Terms of the Review Engagement (Ref: Para. 39)

A58. A request from the entity for the practitioner to change the terms of the review engagement may result from factors including:

- A change in circumstances affecting the need for the service.
- Misunderstanding as to the nature of a review engagement as originally requested.
- A restriction on the scope of the review engagement, whether imposed by management or caused by other circumstances.

A59. A change in circumstances that affects the entity's requirements or a misunderstanding concerning the nature of the service originally requested may be considered a reasonable basis for requesting a change to the terms of the review engagement.

A60. In contrast, a change may not be considered reasonable if it appears that the change relates to information that is incorrect, incomplete or otherwise unsatisfactory. An example might be where the practitioner is unable to obtain sufficient appropriate evidence for a material item in the financial statements, and management asks for the engagement to be changed to a related services engagement to avoid the expression of a modified conclusion by the practitioner.

Request to Change the Nature of the Engagement (Ref: Para. 40)

A61. Before agreeing to change a review engagement to another type of engagement or related service, a practitioner who was engaged to perform a review in accordance with this HKSRE may need to assess, in addition to the matters referred to in this HKSRE, any legal or contractual implications of the change.

A62. If the practitioner concludes that there is reasonable justification to change the review engagement to another type of engagement or related service, the work performed in the review engagement to the date of change may be relevant to the changed engagement; however, the work required to be performed and the report to be issued would be those appropriate to the revised engagement. In order to avoid confusing the reader, the report on the other engagement or related service would not include reference to:

(a) The original review engagement; or

(b) Any procedures that may have been performed in the original review engagement, except where the review engagement is changed to an engagement to perform agreed-upon procedures and thus reference to the procedures performed is a normal part of the report.

Communication with Management and Those Charged with Governance (Ref: Para. 42)

A63. In a review engagement, the practitioner's communications with management and those charged with governance take the form of:

(a) Inquiries the practitioner makes in the course of performing the procedures for the review; and

(b) Other communications, in the context of having effective two-way communication to understand matters arising and to develop a constructive working relationship for the engagement.

A64. The appropriate timing for communications will vary with the circumstances of the engagement. Relevant factors include the significance and nature of the matter, and any action expected to be taken by management or those charged with governance. For example, it may be appropriate to communicate a significant difficulty encountered during the review as soon as practicable if management or those charged with governance are able to assist the practitioner to overcome the difficulty.

A65. Law or regulation may restrict the practitioner's communication of certain matters with those charged with governance. For example, law or regulation may specifically prohibit a communication, or other action, that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act. In some circumstances, potential conflicts between the practitioner's obligations of confidentiality and obligations to communicate may be complex. In such cases, the practitioner may consider obtaining legal advice.

Communicating Matters Concerning the Review

A66. Matters to be communicated to management or those charged with governance, as appropriate, under this HKSRE may include:

- The practitioner's responsibilities in the review engagement, as included in the engagement letter or other suitable form of written agreement.
- Significant findings from the review, for example:
    - ○ The practitioner's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures.

- ○ Significant findings from the performance of procedures, including situations where the practitioner considered performance of additional procedures necessary under this HKSRE. The practitioner may need to confirm that those charged with governance have the same understanding of the facts and circumstances relevant to specific transactions or events.

- ○ Matters arising that may lead to modification of the practitioner's conclusion.

- ○ Significant difficulties, if any, encountered during the review; for example, unavailability of expected information; unexpected inability to obtain evidence that the practitioner considers necessary for the review; or restrictions imposed on the practitioner by management. In some circumstances, such difficulties may constitute a scope limitation that, if not addressed by management or those charged with governance, may lead to modification of the practitioner's conclusion or to the practitioner's withdrawal from the engagement in certain circumstances.

A67. In some entities, different persons are responsible for the management and the governance of an entity. In these circumstances, management may have the responsibility to communicate matters of governance interest to those charged with governance. Communication by management with those charged with governance of matters that the practitioner is required to communicate does not relieve the practitioner of the responsibility to also communicate them to those charged with governance. However, communication of these matters by management may affect the form or timing of the practitioner's communication with those charged with governance.

Communication with Third Parties

A68. In some jurisdictions, the practitioner may be required by law or regulation to, for example:

- Notify a regulatory or enforcement body of certain matters communicated with those charged with governance. For example, in some jurisdictions the practitioner has a duty to report misstatements to authorities where management and those charged with governance fail to take corrective action.

- Submit copies of certain reports prepared for those charged with governance to relevant regulatory or funding bodies or, in some cases, make such reports publicly available.

A69. Unless required by law or regulation to provide a third party with a copy of the practitioner's written communications with those charged with governance, the practitioner may need the prior consent of management or those charged with governance before doing so.

Performing the Engagement

Materiality in a Review of Financial Statements (Ref: Para. 43)

A70. The practitioner's consideration of materiality is made in the context of the applicable financial reporting framework. Some financial reporting frameworks discuss the concept of materiality in the context of the preparation and presentation of financial statements. Although financial reporting frameworks may discuss materiality in different terms, they generally explain that:

- Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements;

- Judgments about materiality are made in light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both; and

- Judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.

A71. If present in the applicable financial reporting framework, a discussion of the concept of materiality provides a frame of reference for the practitioner in determining materiality for the review. If not present, the above considerations provide the practitioner with a frame of reference.

A72. The practitioner's determination of materiality is a matter of professional judgment, and is affected by the practitioner's perception of the needs of the intended users of the financial statements. In this context, it is reasonable for the practitioner to assume that users:

- Have a reasonable knowledge of business and economic activities and accounting, and a willingness to study the information in the financial statements with reasonable diligence;

- Understand that financial statements are prepared, presented and reviewed to levels of materiality;

- Recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment and the consideration of future events; and

- Make reasonable economic decisions on the basis of the information in the financial statements.

Further, unless the review engagement is undertaken for financial statements that are intended to meet the particular needs of specific users, the possible effect of misstatements on specific users, whose information needs may vary widely, is not ordinarily considered.

A73. The practitioner's judgment about what is material in relation to the financial statements as a whole is the same regardless of the level of assurance obtained by a practitioner as the basis for expressing the conclusion on the financial statements.

Revising Materiality (Ref: Para. 44)

A74. The practitioner's determination of materiality for the financial statements as a whole may need to be revised during the engagement as a result of:

- A change in the circumstances that occurred during the review (for example, a decision to dispose of a major part of the entity's business).

- New information, or a change in the practitioner's understanding of the entity and its environment as a result of performing procedures for the review in accordance with this HKSRE (for example, if during the review it appears as though actual financial results are likely to be substantially different from the anticipated period-end financial results that were used initially to determine materiality for the financial statements as a whole).

The Practitioner's Understanding (Ref: Para. 45–46)

A75. The practitioner uses professional judgment to determine the extent of the understanding of the entity and its environment required to perform the review of the entity's financial statements in accordance with this HKSRE. The practitioner's primary consideration is whether the understanding obtained is sufficient to meet the practitioner's objectives for the engagement. The breadth and depth of the overall understanding that the practitioner obtains is less than that possessed by management.

A76. Obtaining an understanding of the entity and its environment is a continual dynamic process of gathering, updating and analyzing information throughout the review engagement. The practitioner's understanding is obtained and applied on an iterative basis throughout performance of the engagement, and is updated as changes in conditions and circumstances occur. Initial procedures for engagement acceptance and continuance at the time of commencement of a review engagement are based on the practitioner's preliminary understanding of the entity and of the engagement circumstances. In a continuing client relationship, the practitioner's understanding includes knowledge obtained from prior engagements performed by the practitioner in relation to the entity's financial statements and other financial information.

A77. The understanding establishes a frame of reference within which the practitioner plans and performs the review engagement, and exercises professional judgment throughout the engagement. Specifically, the understanding needs to be sufficient for the practitioner to be able to identify areas in the financial statements where material misstatements are likely to arise, to inform the practitioner's approach to designing and performing procedures to address those areas.

A78. In obtaining an understanding of the entity and its environment, and of the applicable financial reporting framework, the practitioner may also consider:

- Whether the entity is a component of a group of entities, or an associated entity of another entity.
- The complexity of the financial reporting framework.
- The entity's financial reporting obligations or requirements, and whether those obligations or requirements exist under applicable law or regulation or in the context of voluntary financial reporting arrangements established under formalized governance or accountability arrangements, for example, under contractual arrangements with third parties.
- Relevant provisions of laws and regulations that are generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements, such as tax and pension laws and regulations.
- The level of development of the entity's management and governance structure regarding management and oversight of the entity's accounting records and financial reporting systems that underpin preparation of the financial statements. Smaller entities often have fewer employees, which may influence how management exercises oversight. For example, segregation of duties may not be practicable. However, in a small owner-managed entity, the owner-manager may be able to exercise more effective oversight than in a larger entity. This oversight may compensate for the generally more limited opportunities for segregation of duties.
- The "tone at the top" and the entity's control environment through which the entity addresses risks relating to financial reporting and compliance with the entity's financial reporting obligations.

- The level of development and complexity of the entity's financial accounting and reporting systems and related controls through which the entity's accounting records and related information are maintained.

- The entity's procedures for recording, classifying and summarizing transactions, accumulating information for inclusion in the financial statements and related disclosures.

- The types of matters that required accounting adjustments in the entity's financial statements in prior periods.

Designing and Performing Procedures (Ref: Para. 47, 55)

A79. The planned nature, timing and extent of the procedures the practitioner considers are needed to obtain sufficient appropriate evidence as the basis for a conclusion on the financial statements as a whole are influenced by:

(a) The requirements of this HKSRE; and

(b) Requirements established under applicable law or regulation, including additional reporting requirements contained in applicable laws or regulations.

A80. When the practitioner is engaged to review the financial statements of a group of entities, the planned nature, timing and extent of the procedures for the review are directed at achieving the practitioner's objectives for the review engagement stated in this HKSRE, but in the context of the group financial statements.

A81. The requirements of this HKSRE relating to designing and performing inquiry and analytical procedures, and procedures addressing specific circumstances, are designed to enable the practitioner to achieve the objectives specified in this HKSRE. The circumstances of review engagements vary widely and, accordingly, there may be circumstances where the practitioner may consider it effective or efficient to design and perform other procedures. For example, if in the course of obtaining an understanding of the entity, the practitioner becomes aware of a significant contract the practitioner may choose to read the contract.

A82. The fact that the practitioner may deem it necessary to perform other procedures does not alter the practitioner's objective of obtaining limited assurance in relation to the financial statements as a whole.

Significant or Unusual Transactions

A83. The practitioner may consider~~,~~ reviewing the accounting records with a view to identifying significant or unusual transactions that may require specific attention in the review.

Inquiry (Ref: Para. 46–48)

A84. In a review, inquiry includes seeking information of management and other persons within the entity, as the practitioner considers appropriate in the engagement circumstances. The practitioner may also extend inquiries to obtain non-financial data if appropriate. Evaluating the responses provided by management is integral to the inquiry process.

A85. Depending on the engagement circumstances, inquiries may also include inquiries about:

- Actions taken at meetings of owners, those charged with governance and committees thereof, and proceedings at other meetings, if any, that affect the information and disclosures contained in the financial statements.

- Communications the entity has received, or expects to receive or obtain, from regulatory agencies.

- Matters arising in the course of applying other procedures. When performing further inquiries in relation to identified inconsistencies, the practitioner considers the reasonableness and consistency of management's responses in light of the results obtained from other procedures, and the practitioner's knowledge and understanding of the entity and the industry in which it operates.

A86. Evidence obtained through inquiry is often the principal source of evidence about management intent. However, information available to support management's intent may be limited. In that case, understanding management's past history of carrying out its stated intentions, management's stated reasons for choosing a particular course of action, and management's ability to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry. Application of professional skepticism in evaluating responses provided by management is important to enable the practitioner to evaluate whether there are any matter(s) that would cause the practitioner to believe the financial statements may be materially misstated.

A87. Performing inquiry procedures assists the practitioner also in obtaining or updating the practitioner's understanding of the entity and its environment, to be able to identify areas where material misstatements are likely to arise in the financial statements.

A88. The practitioner may have additional responsibilities under law, regulation or relevant ethical requirements regarding an entity's non-compliance with laws and regulations, including fraud, which may differ from or go beyond this HKSRE, such as:

(a) Responding to identified or suspected non-compliance with laws and regulations, including requirements in relation to specific communications with management and those charged with governance and considering whether further action is needed;

(b) Communicating identified or suspected non-compliance with laws and regulations to an auditor, for example a group engagement partner;[11] and

(c) Documentation requirements regarding identified or suspected non-compliance with laws and regulations.

Complying with any additional responsibilities may provide further information that is relevant to the practitioner's work in accordance with this HKSRE (e.g., regarding the integrity of management or, where appropriate, those charged with governance).

Inquiry about the entity's ability to continue as a going concern (Ref: Para. 48(f))

A89. Often in smaller entities, management may not have prepared an assessment of the entity's ability to continue as a going concern, but instead may rely on knowledge of the business and anticipated future prospects. In these circumstances, it may be appropriate to discuss the medium and long-term prospects and financing of the entity with management, including consideration of whether management's contentions are not inconsistent with the practitioner's understanding of the entity.

[11] See, for example, Sections 225.44–225.48 of the Code.

Analytical Procedures (Ref: Para. 46–47, 49)

A90. In a review of financial statements, performing analytical procedures assists the practitioner in:

- Obtaining or updating the practitioner's understanding of the entity and its environment, including to be able to identify areas where material misstatements are likely to arise in the financial statements.

- Identifying inconsistencies or variances from expected trends, values or norms in the financial statements such as the level of congruence of the financial statements with key data, including key performance indicators.

- Providing corroborative evidence in relation to other inquiry or analytical procedures already performed.

- Serving as additional procedures when the practitioner becomes aware of matter(s) that cause the practitioner to believe that the financial statements may be materially misstated. An example of such an additional procedure is a comparative analysis of monthly revenue and cost figures across profit centers, branches or other components of the entity, to provide evidence about financial information contained in line items or disclosures contained in the financial statements.

A91. Various methods may be used to perform analytical procedures. These methods range from performing simple comparisons to performing complex analysis using statistical techniques. The practitioner may, for example, apply analytical procedures to evaluate the financial information underlying the financial statements through analysis of plausible relationships among both financial and non-financial data, and assessment of results for consistency with expected values with a view to identifying relationships and individual items that appear unusual, or that vary from expected trends or values. The practitioner would compare recorded amounts, or ratios developed from recorded amounts, to expectations developed by the practitioner from information obtained from relevant sources. Examples of sources of information the practitioner often uses to develop expectations, depending on the engagement circumstances, include:

- Financial information for comparable prior period(s), taking known changes into account.

- Information about expected operating and financial results, such as budgets or forecasts including extrapolations from interim or annual data.

- Relationships among elements of financial information within the period.

- Information regarding the industry in which the entity operates, such as gross margin information, or comparison of the entity's ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry.

- Relationships of financial information with relevant non-financial information, such as payroll costs to number of employees.

A92. The practitioner's consideration of whether data to be used for analytical procedures are satisfactory for the intended purpose(s) of those procedures is based on the practitioner's understanding of the entity and its environment, and is influenced by the nature and source of the data, and by the circumstances in which the data are obtained. The following considerations may be relevant:

- Source of the information available. For example, information may be more reliable when it is obtained from independent sources outside the entity;
- Comparability of the information available. For example, broad industry data may need to be supplemented or be adjusted to be comparable to data of an entity that produces and sells specialized products;
- Nature and relevance of the information available; for example, whether the entity's budgets are established as results to be expected rather than as goals to be achieved; and
- The knowledge and expertise involved in the preparation of the information, and related controls that are designed to ensure its completeness, accuracy and validity. Such controls may include, for example, controls over the preparation, review and maintenance of budgetary information.

Procedures to Address Specific Circumstances

Fraud and non-compliance with laws and regulations (Ref: Para. 52(a) and (d))

Communication with management and those charged with governance

A93. In some jurisdictions, law or regulation may restrict the practitioner's communication of certain matters with management or those charged with governance. Law or regulation may specifically prohibit a communication, or other action, that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act, including alerting the entity, for example, when the practitioner is required to report identified or suspected non-compliance with laws and regulations to an appropriate authority pursuant to anti-money laundering legislation.[11a] In these circumstances, the issues considered by the practitioner may be complex and the practitioner may consider it appropriate to obtain legal advice.

Reporting of identified or suspected non-compliance with laws and regulations to an appropriate authority outside the entity

A94. Reporting identified or suspected non-compliance with laws and regulations to an appropriate authority outside the entity may be required or appropriate in the circumstances because:

(a) Law, regulation or relevant ethical requirements require the practitioner to report;

(b) The practitioner has determined reporting is an appropriate action to respond to identified or suspected non-compliance in accordance with relevant ethical requirements (see paragraph A95); or

(c) Law, regulation or relevant ethical requirements provide the practitioner with the right to do so (see paragraph A96).

[11a] Additional guidance is provided in Appendix 4 of HKSA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*.

A95. In some cases, the relevant ethical requirements may require the practitioner to report or to consider whether reporting identified or suspected fraud or non-compliance with laws and regulations to an appropriate authority outside the entity is an appropriate action in the circumstances. For example, the Code requires the practitioner to take steps to respond to identified or suspected non-compliance with laws and regulations, and consider whether further action is needed, which may include reporting to an appropriate authority outside the entity.[12] The Code explains that such reporting would not be considered a breach of the duty of confidentiality under the Code.[13]

A96. Even if law, regulation or relevant ethical requirements do not include requirements that address reporting identified or suspected non-compliance, they may provide the practitioner with the right to report identified or suspected fraud or non-compliance with laws and regulations to an appropriate authority outside the entity.

A97. In other circumstances, the reporting of identified or suspected non-compliance with laws and regulations to an appropriate authority outside the entity may be precluded by the practitioner's duty of confidentiality under law, regulation or relevant ethical requirements.

A98. The determination required by paragraph 52(d) may involve complex considerations and professional judgments. Accordingly, the practitioner may consider consulting internally (e.g., within the firm or a network firm) or on a confidential basis with a regulator or a professional body (unless doing so is prohibited by law or regulation or would breach the duty of confidentiality). The practitioner may also consider obtaining legal advice to understand the practitioner's options and the professional or legal implications of taking any particular course of action.

Events or conditions that may cast doubt regarding use of the going concern assumption in the financial statements (Ref: Para. 54)

A99. The list of factors below gives examples of events or conditions that, individually or collectively, may cast significant doubt about the going concern assumption. The list is not all-inclusive, and the existence of one or more of the items does not always signify that uncertainty exists about whether the entity can continue as a going concern.

Financial

- Net liability or net current liability position
- Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment, or excessive reliance on short-term borrowings to finance long-term assets
- Indications of withdrawal of financial support by creditors
- Negative operating cash flows indicated by historical or prospective financial statements
- Adverse key financial ratios
- Substantial operating losses or significant deterioration in the value of assets used to generate cash flows
- Arrears or discontinuance of dividends

[12] See, for example, Sections 225.51-225.52 of the Code.
[13] See, for example, Section 140.7 and Section 225.53 of the Code.

- Inability to pay creditors on due dates
- Inability to comply with the terms of loan agreements
- Change from credit to cash-on-delivery transactions with suppliers
- Inability to obtain financing for essential new product development or other essential investments

Operating

- Management intentions to liquidate the entity or to cease operations
- Loss of key management without replacement
- Loss of a major market, key customer(s), franchise, license, or principal supplier(s)
- Labor difficulties
- Shortages of important supplies
- Emergence of a highly successful competitor

Other

- Non-compliance with capital or other statutory requirements
- Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy
- Changes in law or regulation or government policy expected to adversely affect the entity
- Uninsured or underinsured catastrophes when they occur

The significance of such events or conditions often can be mitigated by other factors. For example, the effect of an entity being unable to make its normal debt repayments may be counter-balanced by management's plans to maintain adequate cash flows by alternative means, such as by disposing of assets, rescheduling loan repayments, or obtaining additional capital. Similarly, the loss of a principal supplier may be mitigated by the availability of a suitable alternative source of supply.

Reconciling the Financial Statements to the Underlying Accounting Records (Ref: Para. 56)

A100. The practitioner ordinarily obtains evidence that the financial statements agree with, or reconcile to, the underlying accounting records by tracing the financial statement amounts and balances to the relevant accounting records such as the general ledger, or to a summary record or schedule that reflects the agreement or reconciliation of the financial statement amounts with the underlying accounting records (such as a trial balance).

Performing Additional Procedures (Ref: Para. 57)

A101. Additional procedures are required under this HKSRE if the practitioner becomes aware of a matter that causes the practitioner to believe the financial statements may be materially misstated.

A102. The practitioner's response in undertaking additional procedures with respect to an item the practitioner has cause to believe may be materially misstated in the financial statements will vary, depending on the circumstances, and is a matter for the practitioner's professional judgment.

A103. The practitioner's judgment about the nature, timing and extent of additional procedures that are needed to obtain evidence to either conclude that a material misstatement is not likely, or determine that a material misstatement exists, is guided by:

- Information obtained from the practitioner's evaluation of the results of the procedures already performed;
- The practitioner's updated understanding of the entity and its environment obtained throughout the course of the engagement; and
- The practitioner's view on the persuasiveness of evidence needed to address the matter that causes the practitioner to believe that the financial statements may be materially misstated.

A104. Additional procedures focus on obtaining sufficient appropriate evidence to enable the practitioner to form a conclusion on matters that the practitioner believes may cause the financial statements to be materially misstated. The procedures may be:

- Additional inquiry or analytical procedures, for example, being performed in greater detail or being focused on the affected items (i.e. amounts or disclosures concerning the affected accounts or transactions as reflected in the financial statements); or
- Other types of procedures, for example, substantive test of details or external confirmations.

A105. The following example illustrates the practitioner's evaluation of the need to perform additional procedures, and the practitioner's response when the practitioner believes additional procedures are necessary.

- In the course of performing the inquiry and analytical procedures for the review, the practitioner's analysis of accounts receivable shows a material amount of past due accounts receivable, for which there is no allowance for bad or doubtful debts.
- This causes the practitioner to believe that the accounts receivable balance in the financial statements may be materially misstated. The practitioner then inquires of management whether there are uncollectible accounts receivable that would need to be shown as being impaired.
- Depending on management's response, the practitioner's evaluation of the response may:

  (a) Enable the practitioner to conclude that the accounts receivable balance is not likely to be materially misstated. In that case, no further procedures are required.

  (b) Enable the practitioner to determine that the matter causes the financial statements to be materially misstated. No further procedures are required, and the practitioner would form the conclusion that the financial statements as a whole are materially misstated.

  (c) Lead the practitioner to continue to believe that the accounts receivable balance is likely to be materially misstated, while not providing sufficient appropriate evidence for the practitioner to determine that they are in fact misstated.

In that case, the practitioner is required to perform additional procedures, for example, requesting from management an analysis of amounts received for those accounts after the balance sheet date to identify uncollectible accounts receivable. The evaluation of the results of the additional procedures may enable the practitioner to get to (a) or (b) above. If not, the practitioner is required to:

(i) Continue performing additional procedures until the practitioner reaches either (a) or (b) above; or

(ii) If the practitioner is not able to either conclude that the matter is not likely to cause the financial statements as a whole to be materially misstated, or to determine that the matter does cause the financial statements as a whole to be materially misstated, then a scope limitation exists and the practitioner is not able to form an unmodified conclusion on the financial statements.

Written Representations (Ref: Para. 61–63)

A106. Written representations are an important source of evidence in a review engagement. If management modifies or does not provide the requested written representations, it may alert the practitioner to the possibility that one or more significant issues may exist. Further, a request for written, rather than oral, representations in many cases may prompt management to consider such matters more rigorously, thereby enhancing the quality of the representations.

A107. In addition to the written representations required under this HKSRE, the practitioner may consider it necessary to request other written representations about the financial statements. These may be needed, for example, to complete the practitioner's evidence with respect to certain items or disclosures reflected in the financial statements where the practitioner considers such representations to be important in forming a conclusion on the financial statements on either a modified or unmodified basis.

A108. In some cases, management may include in the written representations qualifying language to the effect that representations are made to the best of management's knowledge and belief. It is reasonable for the practitioner to accept such wording if the practitioner is satisfied that the representations are being made by those with appropriate responsibilities and knowledge of the matters included in the representations.

Evaluating Evidence Obtained from the Procedures Performed (Ref: Para. 66–68)

A109. In some circumstances, the practitioner may not have obtained the evidence that the practitioner had expected to obtain through the design of primarily inquiry and analytical procedures and procedures addressing specific circumstances. In these circumstances, the practitioner considers that the evidence obtained from the procedures performed is not sufficient and appropriate to be able to form a conclusion on the financial statements. The practitioner may:

- Extend the work performed; or
- Perform other procedures judged by the practitioner to be necessary in the circumstances.

Where neither of these is practicable in the circumstances, the practitioner will not be able to obtain sufficient appropriate evidence to be able to form a conclusion and is required by this HKSRE to determine the effect on the practitioner's report, or on the practitioner's ability to complete the engagement, for example, if a member of management is unavailable at the time of the review to respond to the practitioner's inquiries on significant matters. This situation may arise even though the practitioner has not become aware of a matter(s) that causes the practitioner to believe the financial statements may be materially misstated, as addressed in paragraph 57.

Scope Limitations

A110. Inability to perform a specific procedure does not constitute a limitation on the scope of the review if the practitioner is able to obtain sufficient appropriate evidence by performing other procedures.

A111. Limitations on the scope of the review imposed by management may have other implications for the review, such as for the practitioner's consideration of areas where the financial statements are likely to be materially misstated, and engagement continuance.

Forming the Practitioner's Conclusion on the Financial Statements

Description of the Applicable Financial Reporting Framework (Ref: Para. 69(a))

A112. The description of the applicable financial reporting framework in the financial statements is important because it advises users of the financial statements of the framework on which the financial statements are based. If the financial statements are special purpose financial statements, they may be prepared under a special purpose financial reporting framework that is available only to the engaging party and the practitioner. Description of the special purpose financial reporting framework used is important as the special purpose financial statements may not be appropriate for any use other than the intended use identified for the special purpose financial statements.

A113. A description of the applicable financial reporting framework that contains imprecise qualifying or limiting language (for example, "the financial statements are in substantial compliance with Hong Kong Financial Reporting Standards") is not an adequate description of that framework as it may mislead users of the financial statements.

Disclosure of Effects of Material Transactions and Events on Information Conveyed in the Financial Statements (Ref: Para. 69(b)(vi), 71)

A114. The practitioner is required under this HKSRE to evaluate whether the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the entity's financial position, financial performance and cash flows.

A115. In the case of financial statements prepared in accordance with the requirements of a fair presentation framework, management may need to include additional disclosures in the financial statements beyond those specifically required by the applicable financial reporting framework or, in extremely rare circumstances, to depart from a requirement in the framework, in order to achieve the fair presentation of the financial statements.

Considerations When a Compliance Framework Is Used

A116. It will be extremely rare for the practitioner to consider financial statements prepared in accordance with a compliance framework to be misleading if, in accordance with this HKSRE, the practitioner has determined at the time of engagement acceptance that the framework is acceptable.

Qualitative Aspects of the Entity's Accounting Practices (Ref: Para. 70(b))

A117. In considering the qualitative aspects of the entity's accounting practices, the practitioner may become aware of possible bias in management's judgments. The practitioner may conclude that the cumulative effect of a lack of neutrality, together with the effect of apparent uncorrected misstatements, causes the financial statements as a whole to be materially misstated. Indicators of a lack of neutrality that may affect the practitioner's evaluation of whether the financial statements as a whole may be materially misstated include the following:

- The selective correction of apparent misstatements brought to management's attention during the review (for example, correcting misstatements with the effect of increasing reported earnings, but not correcting misstatements that have the effect of decreasing reported earnings).
- Possible management bias in the making of accounting estimates.

A118. Indicators of possible management bias do not necessarily mean there are misstatements for purposes of drawing conclusions on the reasonableness of individual accounting estimates. They may, however, affect the practitioner's consideration of whether the financial statements as a whole may be materially misstated.

Form of the Conclusion (Ref: Para. 74)

Description of the Information the Financial Statements Present

A119. In the case of financial statements prepared in accordance with a fair presentation framework, the practitioner's conclusion states that nothing has come to the practitioner's attention that causes the practitioner to believe that the financial statements do not present fairly, in all material respects, … (or do not give a true and fair view of …) in accordance with [the applicable fair presentation framework]. In the case of many general purpose frameworks, for example, the financial statements are required to fairly present (or give a true and fair view of) the financial position of the entity as at the end of a period, and the entity's financial performance and cash flows for that period.

"Present fairly, in all material respects" or "gives a true and fair view"

A120. Whether the phrase "present fairly, in all material respects," or the phrase "gives a true and fair view" is used in any particular jurisdiction is determined by the law or regulation governing the review of financial statements in that jurisdiction, or by generally accepted practice in that jurisdiction. Where law or regulation requires the use of different wording, this does not affect the requirement in this HKSRE for the practitioner to evaluate the fair presentation of financial statements prepared in accordance with a fair presentation framework.

Inability to Form a Conclusion Due to a Management-Imposed Limitation on the Scope of the Review after Engagement Acceptance (Ref: Para. 15, 82)

A121. The practicality of withdrawing from the engagement may depend on the stage of completion of the engagement at the time that management imposes the scope limitation. If the practitioner has substantially completed the review, the practitioner may decide to complete the review to the extent possible, disclaim a conclusion and explain the scope limitation in the paragraph in the report that describes the basis for disclaiming a conclusion.

A122. In certain circumstances, withdrawal from the engagement may not be possible if the practitioner is required by law or regulation to continue the engagement. For example, this may be the case for a practitioner appointed to review the financial statements of a public sector entity. It may also be the case in jurisdictions where the practitioner is appointed to review the financial statements covering a specific period, or appointed for a specific period, and is prohibited from withdrawing before the completion of the review of those financial statements or before the end of that period, respectively. The practitioner may also consider it necessary to include an Other Matter paragraph in the practitioner's report to explain why it is not possible for the practitioner to withdraw from the engagement.

Communication with Regulators or the Entity's Owners

A123. When the practitioner concludes that withdrawal from the engagement is necessary because of a scope limitation, there may be a professional, legal or regulatory requirement for the practitioner to communicate matters relating to the withdrawal from the engagement to regulators or the entity's owners.

The Practitioner's Report (Ref: Para. 86–92)

A124. The written report encompasses reports issued in hard copy format and those using an electronic medium.

Elements of the Practitioner's Report (Ref: Para. 86)

A125. A title indicating the report is the report of an independent practitioner, for example, "Independent Practitioner's Review Report," affirms that the practitioner has met all of the relevant ethical requirements regarding independence and, therefore, distinguishes the independent practitioner's report from reports issued by others.

A126. Law or regulation may specify to whom the practitioner's report is to be addressed in that particular jurisdiction. The practitioner's report is normally addressed to those for whom the report is prepared, often either to the shareholders or to those charged with governance of the entity whose financial statements are being reviewed.

A127. When the practitioner is aware that the financial statements that have been reviewed will be included in a document that contains other information, such as a financial report, the practitioner may consider, if the form of presentation allows, identifying the page numbers on which the financial statements that have been reviewed are presented. This helps users to identify the financial statements to which the practitioner's report relates.

Management's Responsibility for the Financial Statements (Ref: Para. 86(d))

A128. The requirement of this HKSRE that the practitioner must obtain management's agreement that it acknowledges and understands its responsibilities, both in relation to the preparation of the financial statements and in relation to the review engagement, is fundamental to performing the review and reporting on the engagement. The description of management's responsibilities in the practitioner's report provides context for readers of the practitioner's report about management's responsibilities, as they relate to the review engagement performed.

A129. The practitioner's report need not refer specifically to "management" but instead may use the term that is appropriate in the context of the legal framework in the particular jurisdiction. In some jurisdictions, the appropriate reference is to those charged with governance of the entity.

A130. There may be circumstances when it is appropriate for the practitioner to add to the description of management's responsibilities as described in this HKSRE to reflect additional responsibilities that are relevant to the preparation of the financial statements in the context of a jurisdiction, or due to the type of entity.

A131. In some jurisdictions, law or regulation prescribing management's responsibilities may specifically refer to a responsibility for the adequacy of the accounting books and records, or accounting system. As books, records and systems are an integral part of internal control, this HKSRE does not use these descriptions or make any specific reference to them.

The Practitioner's Responsibility (Ref: Para. 86(f))

A132. The practitioner's report states that the practitioner's responsibility is to express a conclusion on the financial statements based on the review performed, in order to contrast the practitioner's responsibility with management's responsibility for preparation of the financial statements.

Reference to standards (Ref: Para. 86(f))

A133. The reference to the standards used by the practitioner for the review conveys to the users of the practitioner's report that the review has been conducted in accordance with established standards.

Communication of the Nature of a Review of Financial Statements (Ref: Para. 86(g))

A134. The description of the nature of a review engagement in the practitioner's report explains the scope and limitations of the engagement undertaken for the benefit of the readers of the report. This explanation clarifies, for avoidance of doubt, that the review is not an audit and that accordingly, the practitioner does not express an audit opinion on the financial statements.

Description of the Applicable Financial Reporting Framework and How it May Affect the Practitioner's Conclusion (Ref: Para. 86(i)(ii))

A135. The identification of the applicable financial reporting framework in the practitioner's conclusion is intended to advise users of the practitioner's report of the context in which that conclusion is expressed. It is not intended to limit the evaluation required in paragraph 30(a). The applicable financial reporting framework is identified in such terms as:

"… in accordance with Hong Kong Financial Reporting Standards;" or

"… in accordance with accounting principles generally accepted in Jurisdiction X …"

A136. When the applicable financial reporting framework encompasses financial reporting standards and legal or regulatory requirements, the framework is identified in such terms as "… in accordance with Hong Kong Financial Reporting Standards and the requirements of Jurisdiction X Corporations Act."

Basis for Modification Paragraph When the Conclusion Is Modified (Ref: Para. 85(h)(ii))

A137. An adverse conclusion or a disclaimer of conclusion relating to a specific matter described in the basis for modification paragraph does not justify the omission of a description of other identified matters that would have otherwise required a modification of the practitioner's conclusion. In such cases, the disclosure of such other matters of which the practitioner is aware may be relevant to users of the financial statements.

Signature of the Practitioner (Ref: Para. 86(l))

A138. The practitioner's signature is either in the name of the practitioner's firm, the personal name of the individual practitioner, or both, as appropriate for the particular jurisdiction. In addition to the practitioner's signature, in certain jurisdictions, the practitioner may be required to make a declaration in the practitioner's report about professional designations or recognition by the appropriate licensing authority in that jurisdiction.

Alerting Readers that the Financial Statements Are Prepared in Accordance with a Special Purpose Framework (Ref: Para. 88)

A139. The special purpose financial statements may be used for purposes other than those for which they were intended. For example, a regulator may require certain entities to place the special purpose financial statements on public record. For avoidance of misunderstanding, it is important that the practitioner alert users of the practitioner's report that the financial statements are prepared in accordance with a special purpose framework and, therefore, may not be suitable for another purpose.

Restriction on Distribution or Use

A140. In addition to the alert to the reader of the practitioner's report that is required by this HKSRE when the financial statements are prepared using a special purpose framework, the practitioner may consider it appropriate to indicate that the practitioner's report is intended solely for the specific users. Depending on the law or regulation of the particular jurisdiction, this may be achieved by restricting the distribution or use of the practitioner's report. In these circumstances, the paragraph containing the alert about the use of a special purpose framework may be expanded to include these other matters, and the heading modified accordingly.

Other Reporting Responsibilities (Ref: Para. 91)

A141. In some jurisdictions, the practitioner may have additional responsibilities to report on other matters that are supplementary to the practitioner's responsibility under this HKSRE. For example, the practitioner may be asked to report certain matters if they come to the practitioner's attention during the course of the review of the financial statements. Alternatively, the practitioner may be asked to perform and report on additional specified procedures, or to express a conclusion on specific matters, such as the adequacy of accounting books and records. Standards on engagements to review financial statements in the specific jurisdiction may provide guidance on the practitioner's responsibilities with respect to specific additional reporting responsibilities in that jurisdiction.

A142. In some cases, the relevant law or regulation may require or permit the practitioner to report on these other responsibilities within the practitioner's report on the financial statements. In other cases, the practitioner may be required or permitted to report on them in a separate report.

A143. These other reporting responsibilities are addressed in a separate section of the practitioner's report, to clearly distinguish them from the practitioner's responsibility under this HKSRE to report on the financial statements. Where relevant, this section may contain sub-heading(s) that describe(s) the content of the other reporting responsibility paragraph(s). In some jurisdictions, the additional reporting responsibilities may be addressed in a report that is separate from the practitioner's report provided for the review of the financial statements.

Date of the Practitioner's Report (Ref: Para. 86(k), 92)

A144. The date of the practitioner's report informs the user of the practitioner's report that the practitioner has considered the effect of events and transactions of which the practitioner became aware and that occurred up to that date.

A145. The practitioner's conclusion is provided on the financial statements and the financial statements are the responsibility of management. The practitioner is not in a position to conclude that sufficient appropriate evidence has been obtained until the practitioner is satisfied that all the statements that comprise the financial statements, including the related notes, have been prepared and management has accepted responsibility for them.

A146. In some jurisdictions, law or regulation identifies the individuals or bodies (for example, the directors) that are responsible for concluding that all the statements that comprise the financial statements, including the related notes, have been prepared, and specifies the necessary approval process. In such cases, evidence is obtained of that approval before dating the report on the financial statements. In other jurisdictions, however, the approval process is not prescribed in law or regulation. In such cases, the procedures the entity follows in preparing and finalizing its financial statements in view of its management and governance structures are considered in order to identify the individuals or body with the authority to conclude that all the statements that comprise the financial statements, including the related notes, have been prepared. In some cases, law or regulation may identify the point in the financial statement reporting process at which the review is expected to be complete.

A147. In some jurisdictions, final approval of the financial statements by shareholders is required before the financial statements are issued publicly. In these jurisdictions, final approval by shareholders is not necessary for the practitioner to conclude on the financial statements. The date of approval of the financial statements for purposes of this HKSRE is the earlier date on which those with the recognized authority determine that all the statements that comprise the financial statements, including the related notes, have been prepared and that those with the recognized authority have asserted that they have taken responsibility for them.

Practitioner's Report Prescribed by Law or Regulation (Ref: Para. 34–35, 86)

A148. Consistency in the practitioner's report, when the review has been conducted in accordance with this HKSRE, promotes credibility in the global marketplace by making more readily identifiable those reviews of financial statements that have been conducted in accordance with globally recognized standards. The practitioner's report may refer to this HKSRE when the differences between the legal or regulatory requirements and this HKSRE relate only to the layout or wording of the practitioner's report and, at a minimum, the report complies with the requirements of paragraph 86 of this HKSRE. Accordingly, in such circumstances the practitioner is considered to have complied with the requirements of this HKSRE, even when the layout and wording used in the practitioner's report are specified by legal or regulatory reporting requirements. Where specific requirements in a particular jurisdiction do not conflict with this HKSRE, adoption of the layout and wording used in this HKSRE assists users of the practitioner's report to more readily recognize the practitioner's report as a report on a review of financial statements conducted in accordance with this HKSRE. Circumstances where law or regulation prescribes the layout or wording of the practitioner's report in terms that are significantly different from the requirements of this HKSRE are addressed in the requirements of this HKSRE concerning acceptance of review engagements and continuance of client relationships.

Practitioner's Report for Reviews Conducted in Accordance with Both Relevant Standards of a Specific Jurisdiction and this HKSRE (Ref: Para. 86(f))

A149. When, in addition to complying with the requirements of this HKSRE, the practitioner also complies with other standards, the report may refer to the review having been performed in accordance with both this HKSRE and other standards for engagements to review financial statements. However, a reference to both this HKSRE and other standards is not appropriate if there is a conflict between the requirements of this HKSRE and those in the other standards that would lead the practitioner to form a different conclusion or not to include an Emphasis of Matter paragraph that, in the particular circumstances, would be required by this HKSRE. In such a case, the practitioner's report refers only to the relevant standards (either this HKSRE or the other standards) in accordance with which the practitioner's report has been prepared.

Illustrative Review Reports (Ref: Para. 86)

A150. Appendix 2 to this HKSRE contains illustrations of practitioners' reports for a review of financial statements incorporating the reporting requirements of this HKSRE.

Documentation

Timeliness of Engagement Documentation (Ref: Para. 93)

A151. HKSQC 1 requires the firm to establish time limits that reflect the need to complete the assembly of final engagement files on a timely basis.

Appendix 1

(Ref: Para. A56)

Illustrative Engagement Letter for an Engagement to Review Historical Financial Statements

The following is an example of an engagement letter for a review of general purpose financial statements (prepared in accordance with Hong Kong Financial Reporting Standards (HKFRSs)), which illustrates the relevant requirements and guidance contained in this HKSRE. This letter is not authoritative but is intended only to be a guide that may be used in conjunction with the considerations outlined in this HKSRE. It will need to be varied according to individual requirements and circumstances[13a]. It is drafted to refer to the review of financial statements for a single reporting period and would require adaptation if intended or expected to apply to recurring reviews. It may be appropriate to seek legal advice that any proposed letter is suitable.

***

To the appropriate representative of management or those charged with governance of ABC Company:[14]

[The objective and scope of the review]

You[15] have requested that we review the general purpose financial statements of ABC Company, which comprise the statement of financial position as at 31 December 20X1, and the statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information. We are pleased to confirm our acceptance and our understanding of this review engagement by means of this letter.

Our review will be conducted with the objective of expressing our conclusion on the financial statements. Our conclusion, if unmodified, will be in the form "Based on our review, nothing has come to our attention that causes us to believe that these financial statements do not present fairly, in all material respects, (*or do not give a true and fair view of*) the financial position of the company as at [date] and *(of)* its financial performance and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards (HKFRSs)."

[The practitioner's responsibilities]

We will conduct our review in accordance with Hong Kong Standard on Review Engagements (HKSRE) 2400 (Revised), *Engagements to Review Historical Financial Statements*. HKSRE 2400 (Revised) requires us to conclude whether anything has come to our attention that causes us to believe that the financial statements, taken as a whole, are not prepared in all material respects in accordance with the applicable financial reporting framework. HKSRE 2400 also requires us to comply with relevant ethical requirements.

[13a] Practitioners may consider it appropriate to include a limitation of liability clause in accordance with their firms' risk management policies

[14] The addressees and references in the letter would be those that are appropriate in the circumstances of the engagement, including the relevant jurisdiction. It is important to refer to the appropriate persons—see paragraph 36 of this HKSRE.

[15] Throughout this letter, references to "you," "we," "us," "management," "those charged with governance" and "practitioner" would be used or amended as appropriate in the circumstances.

A review of financial statements in accordance with HKSRE 2400 (Revised) is a limited assurance engagement. We will perform procedures, primarily consisting of making inquiries of management and others within the entity, as appropriate, and applying analytical procedures, and evaluate the evidence obtained. We will also perform additional procedures if we become aware of matters that cause us to believe the financial statements as a whole may be materially misstated. These procedures are performed to enable us to express our conclusion on the financial statements in accordance with HKSRE 2400 (Revised). The procedures selected will depend on what we consider necessary applying our professional judgment, based on our understanding of ABC Company and its environment, and our understanding of HKFRSs and its application in the industry context.

A review is not an audit of the financial statements, therefore:

(a) There is a commensurate higher risk than there would be in an audit, that any material misstatements that exist in the financial statements reviewed may not be revealed by the review, even though the review is properly performed in accordance with HKSRE 2400 (Revised).

(b) In expressing our conclusion from the review of the financial statements, our report on the financial statements will expressly disclaim any audit opinion on the financial statements.

[The responsibilities of management and identification of the applicable financial reporting framework (for purposes of this example, it is assumed that the practitioner has not determined that the law or regulation prescribes those responsibilities in appropriate terms; the descriptions in paragraph 30(b) of this HKSRE are therefore used).]

Our review will be conducted on the basis that [management and, where appropriate, those charged with governance][16] acknowledge and understand that they have the responsibility:

(a) For preparation and fair presentation of the financial statements in accordance with HKFRSs;[17]

(b) For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and

(c) To provide us with:

   (i) Access to all information of which management is aware that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation and other matters;

   (ii) Additional information that we may request from management for the purpose of the review; and

   (iii) Unrestricted access to persons within ABC Company from whom we determine it necessary to obtain evidence.

As part of our review, we will request from [management and, where appropriate, those charged with governance], written confirmation concerning representations made to us in connection with the review.

We look forward to full cooperation from your staff during our review.

[*Other relevant information*]

[*Insert other information, such as fee arrangements, billings and other specific terms, as appropriate*.]

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16 Use terminology as appropriate in the circumstances.

17 Or, if appropriate, "For the preparation of financial statements that give a true and fair view in accordance with HKFRS."

[*Reporting*]

[*Insert appropriate reference to the expected form and content of the practitioner's report.*]

The form and content of our report may need to be amended in the light of our findings obtained from the review.

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our review of the financial statements including our respective responsibilities.

XYZ & Co.

Acknowledged and agreed on behalf of ABC Company by

(signed)

....

Name and Title

Date

Appendix 2

(Ref: Para. A150)

Illustrative Practitioners' Review Reports

Review Reports on General Purpose Financial Statements

Illustrative Review Reports with Unmodified Conclusions

- Illustration 1: A practitioner's report on financial statements prepared in accordance with a fair presentation framework designed to meet the common financial information needs of a wide range of users (for example, the Hong Kong Financial Reporting Standard for Private Entities).

Illustrative Review Reports with Modified Conclusions

- Illustration 2: A practitioner's report containing a qualified conclusion due to an apparent material misstatement of the financial statements. Financial statements prepared in accordance with a compliance framework designed to meet the common information needs of a wide range of users. (Financial statements prepared using a compliance framework)

- Illustration 3: A practitioner's report containing a qualified conclusion due to the practitioner's inability to obtain sufficient appropriate evidence. (Financial statements prepared using a fair presentation framework—HKFRSs)

- Illustration 4: A practitioner's report containing an adverse conclusion due to material misstatement of the financial statements. (Financial statements prepared using a fair presentation framework—HKFRSs)

- Illustration 5: A practitioner's report containing a disclaimer of conclusion due to the practitioner's inability to obtain sufficient appropriate evidence about multiple elements of the financial statements—resulting in inability to complete the review. (Financial statements prepared using a fair presentation framework—HKFRSs)

Review Reports on Special Purpose Financial Statements

- Illustration 6: A practitioner's report on financial statements prepared in accordance with the financial reporting provisions of a contract (for purposes of this illustration, a compliance framework).

- Illustration 7: A practitioner's report on a single financial statement prepared in accordance with the cash receipts and disbursements basis of accounting (for purposes of this illustration, a fair presentation framework).

Illustration 1

Circumstances include the following:

- **Review of a complete set of financial statements.**
- **The financial statements are prepared for a general purpose by management of the entity in accordance with the Hong Kong Financial Reporting Standard for Private Entities.**
- **The terms of the review engagement reflect the description of management's responsibility for the financial statements in paragraph 30(b) of this HKSRE.**
- **In addition to the review of the financial statements, the practitioner has other reporting responsibilities under local law.**

INDEPENDENT PRACTITIONER'S REVIEW REPORT

[Appropriate Addressee]

Report on the Financial Statements[18]

We have reviewed the accompanying financial statements of ABC Company that comprise the statement of financial position as at 31 December 20X1, and the statement of comprehensive income, 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.

Management's[19] *Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the Hong Kong Financial Reporting Standard for Private Entities,[20] and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Practitioner's Responsibility

Our responsibility is to express a conclusion on the accompanying financial statements[20a]. We conducted our review in accordance with Hong Kong Standard on Review Engagements (HKSRE) 2400 (Revised), *Engagements to Review Historical Financial Statements*. HKSRE 2400 (Revised) requires us to conclude whether anything has come to our attention that causes us to believe that the financial statements, taken as a whole, are not prepared in all material respects in accordance with the applicable financial reporting framework. This Standard also requires us to comply with relevant ethical requirements.

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18 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.

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

20 Where management's responsibility is to prepare financial statements that give a true and fair view, this may read: "Management is responsible for the preparation of financial statements that give a true and fair view in accordance with the Hong Kong Financial Reporting Standard for Private Entities, and for such …"

20a Practitioners 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 "Auditor's Duty of Care To Third Parties and The Audit Report".

A review of financial statements in accordance with HKSRE 2400 (Revised) is a limited assurance engagement. The practitioner performs procedures, primarily consisting of making inquiries of management and others within the entity, as appropriate, and applying analytical procedures, and evaluates the evidence obtained.

The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with Hong Kong Standards on Auditing. Accordingly, we do not express an audit opinion on these financial statements.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that these financial statements do not present fairly, in all material respects, (or *do not give a true and fair view of)* the financial position of ABC Company as at 31 December 20X1, and (*of)* its financial performance and cash flows for the year then ended, in accordance with the Hong Kong Financial Reporting Standard for Private Entities.

Report on Other Legal and Regulatory Requirements

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

[Practitioner's signature]

[Date of the practitioner's report]

[Practitioner's address]

<u>Illustration 2</u>

Circumstances include the following:

- **Review of a complete set of financial statements required by law or regulation.**
- **The financial statements are prepared for a general purpose by management of the entity in accordance with the Financial Reporting Framework (XYZ Law) of Jurisdiction X (that is, a financial reporting framework, encompassing law or regulation, designed to meet the common financial information needs of a wide range of users, but which is not a fair presentation framework).**
- **The terms of the review engagement reflect the description of management's responsibility for the financial statements in paragraph 30(b) of this HKSRE.**
- **Based on the review, inventories are misstated. The misstatement is material but not pervasive to the financial statements.**
- **In addition to the review of the financial statements, the practitioner has other reporting responsibilities under local law.**

INDEPENDENT PRACTITIONER'S REVIEW REPORT

[Appropriate Addressee]

Report on the Financial Statements[21]

We have reviewed the accompanying financial statements of ABC Company that comprise the statement of financial position as at 31 December 20X1, and the statement of comprehensive income, 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.

Management's[22] *Responsibility for the Financial Statements*

Management is responsible for the preparation of these financial statements in accordance with XYZ Law of Jurisdiction X, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Practitioner's Responsibility

Our responsibility is to express a conclusion on the accompanying financial statements[22a]. We conducted our review in accordance with Hong Kong Standard on Review Engagements (HKSRE) 2400 (Revised), *Engagements to Review Historical Financial Statements*. HKSRE 2400 (Revised) requires us to conclude whether anything has come to our attention that causes us to believe that the financial statements, taken as a whole, are not prepared in all material respects in accordance with the applicable financial reporting framework. This Standard also requires us to comply with relevant ethical requirements.

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[21] 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.

[22] Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

[22a] Practitioners 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 "Auditor's Duty of Care To Third Parties and The Audit Report".

A review of financial statements in accordance with HKSRE 2400 (Revised) is a limited assurance engagement. The practitioner performs procedures, primarily consisting of making inquiries of management and others within the entity, as appropriate, and applying analytical procedures, and evaluates the evidence obtained.

The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with Hong Kong Standards on Auditing. Accordingly, we do not express an audit opinion on these financial statements.

Basis for Qualified Conclusion

The company's inventories are carried in the statement of financial position at xxx. Management has not stated the inventories at the lower of cost and net realizable value but has stated them solely at cost, which constitutes a departure from the requirements of the Financial Reporting Framework (XYZ Law) of Jurisdiction X. The company's records indicate that, had management stated the inventories at the lower of cost and net realizable value, an amount of xxx would have been required to write the inventories down to their net realizable value. Accordingly, cost of sales would have been increased by xxx, and income tax, net income and shareholders' equity would have been reduced by xxx, xxx and xxx, respectively.

Qualified Conclusion

Based on our review, except for the effects of the matter described in the Basis for Qualified Conclusion paragraph, nothing has come to our attention that causes us to believe that the financial statements of ABC Company are not prepared, in all material respects, in accordance with the Financial Reporting Framework (XYZ Law) of Jurisdiction X.

Report on Other Legal and Regulatory Requirements

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

[Practitioner's signature]

[Date of the practitioner's report]

[Practitioner's address]

Illustration 3

Circumstances include the following:

- **Review of a complete set of general purpose financial statements prepared by management of the entity in accordance with [a financial reporting framework designed to achieve fair presentation other than Hong Kong Financial Reporting Standards].**
- **The terms of the review engagement reflect the description of management's responsibility for the financial statements in paragraph 30(b) of this HKSRE.**
- **The practitioner was unable to obtain sufficient appropriate evidence regarding an investment in a foreign affiliate. The possible effects of the inability to obtain sufficient appropriate evidence are deemed to be material but not pervasive to the financial statements.**
- **The practitioner does not have other reporting responsibilities under local law in addition to the review of the consolidated financial statements.**

INDEPENDENT PRACTITIONER'S REVIEW REPORT

[Appropriate Addressee]

We have reviewed the accompanying financial statements of ABC Company that comprise the statement of financial position as at 31 December 20X1, and the statement of comprehensive income, 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.

Management's[23] Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with [name of applicable financial reporting framework, including a reference to the jurisdiction or country of origin of the financial reporting framework when the financial reporting framework used is not Hong Kong Financial Reporting Standards],[24] and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Practitioner's Responsibility

Our responsibility is to express a conclusion on the accompanying financial statements[24a]. We conducted our review in accordance with Hong Kong Standard on Review Engagements (HKSRE) 2400 (Revised), *Engagements to Review Historical Financial Statements*. HKSRE 2400 (Revised) requires us to conclude whether anything has come to our attention that causes us to believe that the financial statements, taken as a whole, are not prepared in all material respects in accordance with the applicable financial reporting framework. This Standard also requires us to comply with relevant ethical requirements.

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[23] Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

[24] Where management's responsibility is to prepare financial statements that give a true and fair view, this may read: "Management is responsible for the preparation of financial statements that give a true and fair view in accordance with [name of applicable financial reporting framework, including a reference to the jurisdiction or country of origin of the financial reporting framework when the financial reporting framework used is not Hong Kong Financial Reporting Standards], and for such …"

[24a] Practitioners 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 "Auditor's Duty of Care To Third Parties and The Audit Report".

A review of financial statements in accordance with HKSRE 2400 (Revised) is a limited assurance engagement. The practitioner performs procedures, primarily consisting of making inquiries of management and others within the entity, as appropriate, and applying analytical procedures, and evaluates the evidence obtained.

The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with Hong Kong Standards on Auditing. Accordingly, we do not express an audit opinion on these financial statements.

Basis for Qualified Conclusion

ABC Company's investment in XYZ Company, a foreign associate acquired during the year and accounted for by the equity method, is carried at xxx on the statement of financial position as at 31 December 20X1, and ABC's share of XYZ's net income of xxx is included in ABC's income for the year then ended. We were unable to obtain access to the relevant financial information of XYZ concerning the carrying amount of ABC's investment in XYZ as at 31 December 20X1 and ABC's share of XYZ's net income for the year. Consequently, we were unable to perform the procedures we considered necessary.

Qualified Conclusion

Based on our review, except for the possible effects of the matter described in the Basis for Qualified Conclusion paragraph, nothing has come to our attention that causes us to believe that the accompanying financial statements do not present fairly, in all material respects, (or *do not give a true and fair view of)* the financial position of ABC Company as at 31 December 20X1, and (*of*) its financial performance and cash flows for the year then ended in accordance with [name of applicable financial reporting framework, including a reference to the jurisdiction or country of origin of the financial reporting framework when the financial reporting framework used is not Hong Kong Financial Reporting Standards].

[Practitioner's signature]

[Date of the practitioner's report]

[Practitioner's address]

<u>Illustration 4</u>

Circumstances include the following:

- **Review of consolidated general purpose financial statements prepared by management of the parent in accordance with Hong Kong Financial Reporting Standards.**
- **The terms of the review engagement reflect the description of management's responsibility for the financial statements in paragraph 30(b) of this HKSRE.**
- **The financial statements are materially misstated due to the non-consolidation of a subsidiary. The material misstatement is deemed to be pervasive to the financial statements. The effects of the misstatement on the financial statements have not been determined because it was not practicable to do so.**
- **The practitioner does not have other reporting responsibilities under local law in addition to the review of the consolidated financial statements.**

INDEPENDENT PRACTITIONER'S REVIEW REPORT

[Appropriate Addressee]

Report on the Consolidated Financial Statements[25]

We have reviewed the accompanying consolidated financial statements of ABC Company that comprise the consolidated statement of financial position as at 31 December 20X1, and the consolidated statement of comprehensive income, 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.

Management's[26] *Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Hong Kong Financial Reporting Standards,[27] and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Practitioner's Responsibility

Our responsibility is to express a conclusion on these consolidated financial statements[27a]. We conducted our review in accordance with Hong Kong Standard on Review Engagements (HKSRE) 2400 (Revised), *Engagements to Review Historical Financial Statements*. HKSRE 2400 (Revised) requires us to conclude whether anything has come to our attention that causes us to believe that the consolidated financial statements, taken as a whole, are not prepared in all material respects in accordance with the applicable financial reporting framework. This Standard also requires us to comply with relevant ethical requirements.

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

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

27 Where management's responsibility is to prepare financial statements that give a true and fair view, this may read: "Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Hong Kong Financial Reporting Standards, and for such …"

27a Practitioners 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 "Auditor's Duty of Care To Third Parties and The Audit Report".

A review of consolidated financial statements in accordance with HKSRE 2400 (Revised) is a limited assurance engagement. The practitioner performs procedures, primarily consisting of making inquiries of management and others within the entity, as appropriate, and applying analytical procedures, and evaluates the evidence obtained.

The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with Hong Kong Standards on Auditing. Accordingly, we do not express an audit opinion on these consolidated financial statements.

Basis for Adverse Conclusion

As explained in Note X, the company has not consolidated the financial statements of subsidiary XYZ Company it acquired during 20X1 because it has not yet been able to ascertain the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This investment is therefore accounted for on a cost basis. Under Hong Kong Financial Reporting Standards, the subsidiary should have been consolidated because it is controlled by the company. Had XYZ been consolidated, many elements in the accompanying financial statements would have been materially affected.

Adverse Conclusion

Based on our review, due to the significance of the matter discussed in the Basis for Adverse Conclusion paragraph, the consolidated financial statements do not present fairly (or *do not give a true and fair view of*) the financial position of ABC Company and its subsidiaries as at 31 December 20X1, and (*of*) their financial performance and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards.

Report on Other Legal and Regulatory Requirements

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

[Practitioner's signature]

[Date of the practitioner's report]

[Practitioner's address]

Illustration 5

Circumstances include the following:

- **Review of a complete set of general purpose financial statements prepared by management of the entity in accordance with Hong Kong Financial Reporting Standards.**
- **The terms of the review engagement reflect the description of management's responsibility for the financial statements in paragraph 30(b) of this HKSRE.**
- **The practitioner was unable to form a conclusion on the financial statements, due to inability to obtain sufficient appropriate evidence about multiple elements of the financial statements, and the practitioner believes the effect is material and pervasive to the financial statements. Specifically, the practitioner was unable to obtain evidence about the entity's physical inventory and accounts receivable.**

INDEPENDENT PRACTITIONER'S REVIEW REPORT

[Appropriate Addressee]

We were engaged to review the accompanying financial statements of ABC Company that comprise the statement of financial position as at 31 December 20X1, and the statement of comprehensive income, 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.

Management's[28] Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Hong Kong Financial Reporting Standards,[29] and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Practitioner's Responsibility

Our responsibility is to express a conclusion on the accompanying financial statements[29a]. Because of the matter(s) described in the Basis for Disclaimer of Conclusion paragraph, however, we were not able to obtain sufficient appropriate evidence as a basis for expressing a conclusion on the financial statements.

Basis for Disclaimer of Conclusion

Management did not conduct a count of physical inventory on hand at the end of the year. We were unable to perform the procedures we considered necessary concerning the inventory quantities held at 31 December 20X1, which are stated at xxx in the statement of financial position at 31 December 20X1.

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[28] Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

[29] Where management's responsibility is to prepare financial statements that give a true and fair view, this may read: "Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Hong Kong Financial Reporting Standards, and for such …"

[29a] Practitioners 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 "Auditor's Duty of Care To Third Parties and The Audit Report".

In addition, the introduction of a new computerized accounts receivable system in September 20X1 resulted in numerous errors in accounts receivable and inventory. As of the date of our report, management was still in the process of rectifying the system deficiencies and correcting the errors. As a result of these matters, we were unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded inventories and accounts receivable, and the elements making up the statement of comprehensive income, statement of changes in equity and statement of cash flows.

Disclaimer of Conclusion

Due to the significance of the matters described in the Basis for Disclaimer of Conclusion paragraph, we were unable to obtain sufficient appropriate evidence to form a conclusion on the accompanying financial statements. Accordingly, we do not express a conclusion on these financial statements.

[Practitioner's signature]

[Date of the practitioner's report]

[Practitioner's address]

<u>Illustration 6</u>

Circumstances include the following:

- **The financial statements have been prepared by management of the entity in accordance with the financial reporting provisions of a contract (that is, a special purpose framework), to comply with the provisions of the contract. Management does not have a choice of financial reporting frameworks.**
- **The applicable financial reporting framework is a compliance framework.**
- **The terms of the review engagement reflect the description of management's responsibility for the financial statements in paragraph 30(b) of this HKSRE.**
- **Distribution or use of the practitioner's report is restricted.**

INDEPENDENT PRACTITIONER'S REVIEW REPORT

[Appropriate Addressee]

We have reviewed the accompanying financial statements of ABC Company that comprise the balance sheet as at 31 December 20X1, 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 information. The financial statements have been prepared by management of ABC Company based on the financial reporting provisions of Section Z of the contract dated 1 January 20X1 between ABC Company and DEF Company ("the contract").

Management's[30] Responsibility for the Financial Statements

Management is responsible for the preparation of these financial statements in accordance with the financial reporting provisions of Section Z of the contract, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Practitioner's Responsibility

Our responsibility is to express a conclusion on the accompanying financial statements. We conducted our review in accordance with Hong Kong Standard on Review Engagements (HKSRE) 2400 (Revised), *Engagements to Review Historical Financial Statements*. HKSRE 2400 (Revised) requires us to conclude whether anything has come to our attention that causes us to believe that the financial statements, taken as a whole, are not prepared in all material respects in accordance with the applicable financial reporting framework. This Standard also requires us to comply with relevant ethical requirements.

A review of financial statements in accordance with HKSRE 2400 (Revised) is a limited assurance engagement. The practitioner performs procedures, primarily consisting of making inquiries of management and others within the entity, as appropriate, and applying analytical procedures, and evaluates the evidence obtained.

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[30] Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with Hong Kong Standards on Auditing. Accordingly, we do not express an audit opinion on these financial statements.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that these financial statements are not prepared, in all material respects, in accordance with the financial reporting provisions of Section Z of the contract.

Basis of Accounting, and Restriction on Distribution and Use

Without modifying our conclusion, we draw attention to Note X to the financial statements, which describes the basis of accounting. The financial statements are prepared to assist ABC Company to comply with the financial reporting provisions of the contract referred to above. As a result, the financial statements may not be suitable for another purpose. Our report is intended solely for ABC Company and DEF Company and should not be distributed to or used by parties other than ABC Company or DEF Company[30a].

[Practitioner's signature]

[Date of the practitioner's report]

[Practitioner's address]

[30a] Practitioners 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 "Auditor's Duty of Care To Third Parties and The Audit Report".

Illustration 7

Circumstances include the following:

- **Review of a statement of cash receipts and disbursements**
- **The financial statement has been prepared by management of the entity in accordance with the cash receipts and disbursements basis of accounting to respond to a request for cash flow information received from a creditor. The basis of accounting applied to prepare the financial statement has been agreed between the entity and the creditor.**
- **The applicable financial reporting framework is a fair presentation framework designed to meet the financial information needs of specific users.**
- **The practitioner has determined that it is appropriate to use the phrase "presents fairly, in all material respects," in the practitioner's conclusion.**
- **The terms of the review engagement reflect the description of management's responsibility for the financial statement in paragraph 30(b) of this HKSRE.**
- **Distribution or use of the practitioner's report is not restricted.**

INDEPENDENT PRACTITIONER'S REVIEW REPORT

[Appropriate Addressee]

We have reviewed the accompanying statement of cash receipts and disbursements of ABC Company for the year ended 31 December 20X1, and a summary of significant accounting policies and other explanatory information (together "the financial statement"). The financial statement has been prepared by management of ABC Company using the cash receipts and disbursements basis of accounting described in Note X.

Management's[31] Responsibility for the Financial Statement

Management is responsible for the preparation and fair presentation of this financial statement in accordance with the cash receipts and disbursements basis of accounting described in Note X, and for such internal control as management determines is necessary to enable the preparation of the financial statement that is free from material misstatement, whether due to fraud or error.

Practitioner's Responsibility

Our responsibility is to express a conclusion on the accompanying financial statement. We conducted our review in accordance with Hong Kong Standard on Review Engagements (HKSRE) 2400 (Revised), *Engagements to Review Historical Financial Statements*. HKSRE 2400 (Revised) requires us to conclude whether anything has come to our attention that causes us to believe that the financial statement is not prepared in all material respects in accordance with the applicable financial reporting framework. This Standard also requires us to comply with relevant ethical requirements.

A review of financial statements in accordance with HKSRE 2400 (Revised) is a limited assurance engagement. The practitioner performs procedures, primarily consisting of making inquiries of management and others within the entity, as appropriate, and applying analytical procedures, and evaluates the evidence obtained.

[31] Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with Hong Kong Standards on Auditing. Accordingly, we do not express an audit opinion on this financial statement.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the financial statement does not present fairly, in all material respects, (or *does not give a true and fair view of)* the cash receipts and disbursements of ABC Company for the year ended 31 December 20X1 in accordance with the cash receipts and disbursements basis of accounting described in Note X.

Basis of Accounting

Without modifying our conclusion, we draw attention to Note X to the financial statement, which describes the basis of accounting. The financial statement is prepared to provide information to XYZ Creditor. As a result, the financial statement may not be suitable for another purpose[31a].

[Practitioner's signature]

[Date of the practitioner's report]

[Practitioner's address]

[31a] Practitioners 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 "Auditor's Duty of Care To Third Parties and The Audit Report".

HKSAE 3000 (Revised)
Issued March 2014; revised February 2015, January 2019

Hong Kong Standard on Assurance Engagements 3000 (Revised)

Assurance Engagements Other than Audits or Reviews of Historical Financial Information

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

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HONG KONG STANDARD ON ASSURANCE ENGAGEMENTS 3000 (REVISED)

ASSURANCE ENGAGEMENTS OTHER THAN AUDITS OR REVIEWS OF HISTORICAL FINANCIAL INFORMATION

(Effective for assurance reports dated on or after 15 December 2015)

CONTENTS

Hong Kong Standard on Assurance Engagements (HKSAE) 3000 (Revised), *Assurance Engagements other than Audits or Reviews of Historical Financial Information*, should be read in conjunction with the *Amended Preface to the Hong Kong Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements*.

Introduction

1. This Hong Kong Standard on Assurance Engagements (HKSAE) deals with assurance engagements other than audits or reviews of historical financial information, which are dealt with in Hong Kong Standards on Auditing (HKSAs) and Hong Kong Standards on Review Engagements (HKSREs), respectively. (Ref: Para. A21–A22)

2. Assurance engagements include both attestation engagements, in which a party other than the practitioner measures or evaluates the underlying subject matter against the criteria, and direct engagements, in which the practitioner measures or evaluates the underlying subject matter against the criteria. This HKSAE contains requirements and application and other explanatory material specific to reasonable and limited assurance attestation engagements. This HKSAE may also be applied to reasonable and limited assurance direct engagements, adapted and supplemented as necessary in the engagement circumstances.

3. This HKSAE is premised on the basis that:

   (a) The members of the engagement team and the engagement quality control reviewer (for those engagements where one has been appointed) are subject to Parts A, B and D[1a] of the *Code of Ethics for Professional Accountants* issued by the Hong Kong Institute of Certified Public Accountants (the Code) related to assurance engagements, or other professional requirements, or requirements in law or regulation, that are at least as demanding; and (Ref: Para. A30–A34)

   (b) The practitioner who is performing the engagement is a member of a firm that is subject to HKSQC 1,[1] or other professional requirements, or requirements in law or regulation, regarding the firm's responsibility for its system of quality control, that are at least as demanding as HKSQC 1. (Ref: Para. A61–A66)

4. Quality control within firms that perform assurance engagements, and compliance with ethical principles, including independence requirements, are widely recognized as being in the public interest and an integral part of high-quality assurance engagements. Professional accountants in public practice will be familiar with such requirements. If a competent practitioner other than a professional accountant in public practice chooses to represent compliance with this or other HKSAEs, it is important to recognize that this HKSAE includes requirements that reflect the premise in the preceding paragraph.

Scope

5. This HKSAE covers assurance engagements other than audits or reviews of historical financial information, as described in the *Hong Kong Framework for Assurance Engagements* (Assurance Framework). Where a subject-matter specific HKSAE is relevant to the subject matter of a particular engagement, that HKSAE applies in addition to this HKSAE. (Ref: Para. A21–A22)

6. Not all engagements performed by practitioners are assurance engagements. Other frequently performed engagements that are not assurance engagements, as defined by paragraph 12(a) (and therefore are not covered by the HKSAEs) include:

   (a) Engagements covered by Hong Kong Standards on Related Services (HKSRS), such as agreed-upon procedure and compilation engagements; [2]

[1a] The Code has an additional Part D, which are either local application or represent an amplification of provisions in Parts A, B and C. There are relevant sections in Part A and Part B for which there are additional requirements in Part D or additional local requirements.

[1] Hong Kong Standard on Quality Control (HKSQC) 1, Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements

[2] HKSRS 4400, Engagements to Perform Agreed-Upon Procedures Regarding Financial Information, and HKSRS 4410 (Revised), Compilation Engagements

(b) The preparation of tax returns where no assurance conclusion is expressed; and

(c) Consulting (or advisory) engagements, such as management and tax consulting. (Ref: Para. A1)

7. An assurance engagement performed under the HKSAEs may be part of a larger engagement. In such circumstances, the HKSAEs are relevant only to the assurance portion of the engagement.

8. The following engagements, which may be consistent with the description in paragraph 12(a), are not considered assurance engagements in terms of the HKSAEs:

(a) Engagements to testify in legal proceedings regarding accounting, auditing, taxation or other matters; and

(b) Engagements that include professional opinions, views or wording from which a user may derive some assurance, if all of the following apply:

(i) Those opinions, views or wording are merely incidental to the overall engagement;

(ii) Any written report issued is expressly restricted for use by only the intended users specified in the report;

(iii) Under a written understanding with the specified intended users, the engagement is not intended to be an assurance engagement; and

(iv) The engagement is not represented as an assurance engagement in the professional accountant's report.

Effective Date

9. This HKSAE is effective for assurance engagements where the assurance report is dated on or after 15 December 2015.

Objectives

10. In conducting an assurance engagement, the objectives of the practitioner are:

(a) To obtain either reasonable assurance or limited assurance, as appropriate, about whether the subject matter information is free from material misstatement;

(b) To express a conclusion regarding the outcome of the measurement or evaluation of the underlying subject matter through a written report that conveys either a reasonable assurance or a limited assurance conclusion and describes the basis for the conclusion; (Ref: Para. A2) and

(c) To communicate further as required by this HKSAE and any other relevant HKSAEs.

11. In all cases when reasonable assurance or limited assurance, as appropriate, cannot be obtained and a qualified conclusion in the practitioner's assurance report is insufficient in the circumstances for purposes of reporting to the intended users, this HKSAE requires that the practitioner disclaim a conclusion or withdraw (or resign) from the engagement, where withdrawal is possible under applicable law or regulation.

Definitions

12. For purposes of this HKSAE and other HKSAEs, unless indicated to the contrary, the following terms have the meanings attributed below. (Ref: Para. A27)

(a) Assurance engagement—An engagement in which a practitioner aims to obtain sufficient appropriate evidence in order to express a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the subject matter information (that is, the outcome of the measurement or evaluation of an underlying subject matter against criteria). Each assurance engagement is classified on two dimensions: (Ref: Para. A3)

(i) Either a reasonable assurance engagement or a limited assurance engagement:

a. Reasonable assurance engagement—An assurance engagement in which the practitioner reduces engagement risk to an acceptably low level in the circumstances of the engagement as the basis for the practitioner's conclusion. The practitioner's conclusion is expressed in a form that conveys the practitioner's opinion on the outcome of the measurement or evaluation of the underlying subject matter against criteria.

b. Limited assurance engagement—An assurance engagement in which the practitioner reduces engagement risk to a level that is acceptable in the circumstances of the engagement but where that risk is greater than for a reasonable assurance engagement as the basis for expressing a conclusion in a form that conveys whether, based on the procedures performed and evidence obtained, a matter(s) has come to the practitioner's attention to cause the practitioner to believe the subject matter information is materially misstated. The nature, timing and extent of procedures performed in a limited assurance engagement is limited compared with that necessary in a reasonable assurance engagement but is planned to obtain a level of assurance that is, in the practitioner's professional judgment, meaningful. To be meaningful, the level of assurance obtained by the practitioner is likely to enhance the intended users' confidence about the subject matter information to a degree that is clearly more than inconsequential. (Ref: Para. A3–A7)

(ii) Either an attestation engagement or a direct engagement: (Ref: Para. A8)

a. Attestation engagement—An assurance engagement in which a party other than the practitioner measures or evaluates the underlying subject matter against the criteria. A party other than the practitioner also often presents the resulting subject matter information in a report or statement. In some cases, however, the subject matter information may be presented by the practitioner in the assurance report. In an attestation engagement, the practitioner's conclusion addresses whether the subject matter information is free from material misstatement. The practitioner's conclusion may be phrased in terms of: (Ref: Para. A179, A181)

(i) The underlying subject matter and the applicable criteria;

(ii) The subject matter information and the applicable criteria; or

(iii) A statement made by the appropriate party.

b. Direct engagement—An assurance engagement in which the practitioner measures or evaluates the underlying subject matter against the applicable criteria and the practitioner presents the resulting subject matter information as part of, or accompanying, the assurance report. In a direct engagement, the practitioner's conclusion addresses the reported outcome of the measurement or evaluation of the underlying subject matter against the criteria.

(b) Assurance skills and techniques—Those planning, evidence gathering, evidence evaluation, communication and reporting skills and techniques demonstrated by an assurance practitioner that are distinct from expertise in the underlying subject matter of any particular assurance engagement or its measurement or evaluation. (Ref: Para. A9)

(c) Criteria—The benchmarks used to measure or evaluate the underlying subject matter. The "applicable criteria" are the criteria used for the particular engagement. (Ref: Para. A10)

(d) Engagement circumstances—The broad context defining the particular engagement, which includes: the terms of the engagement; whether it is a reasonable assurance engagement or a limited assurance engagement, the characteristics of the underlying subject matter; the measurement or evaluation criteria; the information needs of the intended users; relevant characteristics of the responsible party, the measurer or evaluator, and the engaging party and their environment; and other matters, for example events, transactions, conditions and practices, that may have a significant effect on the engagement.

(e) Engagement partner—The partner or other person in the firm who is responsible for the engagement and its performance, and for the assurance report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body. "Engagement partner" should be read as referring to its public sector equivalents where relevant.

(f) Engagement risk—The risk that the practitioner expresses an inappropriate conclusion when the subject matter information is materially misstated. (Ref: Para. A11–A14)

(g) Engaging party—The party(ies) that engages the practitioner to perform the assurance engagement. (Ref: Para. A15)

(h) Engagement team—All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform procedures on the engagement. This excludes a practitioner's external expert engaged by the firm or a network firm.

(i) Evidence—Information used by the practitioner in arriving at the practitioner's conclusion. Evidence includes both information contained in relevant information systems, if any, and other information. For purposes of the HKSAEs: (Ref: Para. A147–A153)

    (i) Sufficiency of evidence is the measure of the quantity of evidence.

    (ii) Appropriateness of evidence is the measure of the quality of evidence.

(j) Firm—A sole practitioner, partnership or corporation or other entity of individual practitioners. "Firm" should be read as referring to its public sector equivalents where relevant.

(k) Historical financial information—Information expressed in financial terms in relation to a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.

(l) Internal audit function – A function of an entity that performs assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management and internal control processes.

(m) Intended users—The individual(s) or organization(s), or group(s) thereof that the practitioner expects will use the assurance report. In some cases, there may be intended users other than those to whom the assurance report is addressed. (Ref: Para. A16–A18, A37))

(n) Measurer or evaluator—The party(ies) who measures or evaluates the underlying subject matter against the criteria. The measurer or evaluator possesses expertise in the underlying subject matter. (Ref: Para. A37, A39)

(o) Misstatement—A difference between the subject matter information and the appropriate measurement or evaluation of the underlying subject matter in accordance with the criteria. Misstatements can be intentional or unintentional, qualitative or quantitative, and include omissions.

(p) Misstatement of fact (with respect to other information)—Other information that is unrelated to matters appearing in the subject matter information or the assurance report that is incorrectly stated or presented. A material misstatement of fact may undermine the credibility of the document containing the subject matter information.

(q) Other information—Information (other than the subject matter information and the assurance report thereon) which is included, either by law, regulation or custom, in a document containing the subject matter information and the assurance report thereon.

(r) Practitioner—The individual(s) conducting the engagement (usually the engagement partner or other members of the engagement team, or, as applicable, the firm). Where this HKSAE expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the term "engagement partner" rather than "practitioner" is used. (Ref: Para. A37)

(s) Practitioner's expert—An individual or organization possessing expertise in a field other than assurance, whose work in that field is used by the practitioner to assist the practitioner in obtaining sufficient appropriate evidence. A practitioner's expert may be either a practitioner's internal expert (who is a partner or staff, including temporary staff, of the practitioner's firm or a network firm), or a practitioner's external expert.

(t) Professional judgment—The application of relevant training, knowledge and experience, within the context provided by assurance and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the engagement.

(u) Professional skepticism—An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement, and a critical assessment of evidence.

(v) Responsible party—The party(ies) responsible for the underlying subject matter. (Ref: Para. A37)

(w) Risk of material misstatement—The risk that the subject matter information is materially misstated prior to the engagement.

(x) Subject matter information—The outcome of the measurement or evaluation of the underlying subject matter against the criteria, that is, the information that results from applying the criteria to the underlying subject matter. (Ref: Para. A19)

(y) Underlying subject matter—The phenomenon that is measured or evaluated by applying criteria.

13. For the purposes of this HKSAE and other HKSAEs, references to "appropriate party(ies)" should be read hereafter as "the responsible party, the measurer or evaluator, or the engaging party, as appropriate." (Ref: Para. A20, A37)

Requirements

Conduct of an Assurance Engagement in Accordance with HKSAEs

Complying with Standards that are Relevant to the Engagement

14. The practitioner shall comply with this HKSAE and any subject matter-specific HKSAEs relevant to the engagement.

15. The practitioner shall not represent compliance with this or any other HKSAE unless the practitioner has complied with the requirements of this HKSAE and any other HKSAE relevant to the engagement. (Ref: Para. A21–A22, A171)

Text of an HKSAE

16. The practitioner shall have an understanding of the entire text of an HKSAE, including its application and other explanatory material, to understand its objectives and to apply its requirements properly. (Ref: Para. A23–A28)

Complying with Relevant Requirements

17. Subject to the following paragraph, the practitioner shall comply with each requirement of this HKSAE and of any relevant subject matter-specific HKSAE unless, in the circumstances of the engagement the requirement is not relevant because it is conditional and the condition does not exist. Requirements that apply to only limited assurance or reasonable assurance engagements have been presented in a columnar format with the letter "L" (limited assurance) or "R" (reasonable assurance) after the paragraph number. (Ref: Para. A29)

18. In exceptional circumstances, the practitioner may judge it necessary to depart from a relevant requirement in an HKSAE. In such circumstances, the practitioner shall perform alternative procedures to achieve the aim of that requirement. The need for the practitioner to depart from a relevant requirement is expected to arise only where the requirement is for a specific procedure to be performed and, in the specific circumstances of the engagement, that procedure would be ineffective in achieving the aim of the requirement.

Failure to Achieve an Objective

19. If an objective in this HKSAE or a relevant subject matter-specific HKSAE cannot be achieved, the practitioner shall evaluate whether this requires the practitioner to modify the practitioner's conclusion or withdraw from the engagement (where withdrawal is possible under applicable law or regulation). Failure to achieve an objective in a relevant HKSAE represents a significant matter requiring documentation in accordance with paragraph 79 of this HKSAE.

Ethical Requirements

20. The practitioner shall comply with Parts A, B and D of the Code related to assurance engagements, or other professional requirements, or requirements imposed by law or regulation, that are at least as demanding. (Ref: Para. A30–A34, A60)

Acceptance and Continuance

21. The engagement partner shall be satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and assurance engagements have been followed by the firm, and shall determine that conclusions reached in this regard are appropriate.

22. The practitioner shall accept or continue an assurance engagement only when: (Ref: Para. A30–A34)

(a) The practitioner has no reason to believe that relevant ethical requirements, including independence, will not be satisfied;

(b) The practitioner is satisfied that those persons who are to perform the engagement collectively have the appropriate competence and capabilities (see also paragraph 32); and

(c) The basis upon which the engagement is to be performed has been agreed, through:

(i) Establishing that the preconditions for an assurance engagement are present (see also paragraphs 24–26); and

(ii) Confirming that there is a common understanding between the practitioner and the engaging party of the terms of the engagement, including the practitioner's reporting responsibilities.

23. If the engagement partner obtains information that would have caused the firm to decline the engagement had that information been available earlier, the engagement partner shall communicate that information promptly to the firm, so that the firm and the engagement partner can take the necessary action.

Preconditions for the Assurance Engagement

24. In order to establish whether the preconditions for an assurance engagement are present, the practitioner shall, on the basis of a preliminary knowledge of the engagement circumstances and discussion with the appropriate party(ies), determine whether: (Ref: Para. A35–A36)

(a) The roles and responsibilities of the appropriate parties are suitable in the circumstances; and (Ref: Para. A37–A39)

(b) The engagement exhibits all of the following characteristics:

(i) The underlying subject matter is appropriate; (Ref: Para. A40–A44)

(ii) The criteria that the practitioner expects to be applied in the preparation of the subject matter information are suitable for the engagement circumstances, including that they exhibit the following characteristics: (Ref: Para. A45–A50)

a. Relevance.

b. Completeness.

c. Reliability.

d. Neutrality.

e. Understandability.

(iii) The criteria that the practitioner expects to be applied in the preparation of the subject matter information will be available to the intended users; (Ref: Para. A51–A52)

(iv) The practitioner expects to be able to obtain the evidence needed to support the practitioner's conclusion; (Ref: Para. A53–A55)

(v) The practitioner's conclusion, in the form appropriate to either a reasonable assurance engagement or a limited assurance engagement, is to be contained in a written report; and

(vi) A rational purpose including, in the case of a limited assurance engagement, that the practitioner expects to be able to obtain a meaningful level of assurance. (Ref: Para. A56)

25. If the preconditions for an assurance engagement are not present, the practitioner shall discuss the matter with the engaging party. If changes cannot be made to meet the preconditions, the practitioner shall not accept the engagement as an assurance engagement unless required by law or regulation to do so. However, an engagement conducted under such circumstances does not comply with HKSAEs. Accordingly, the practitioner shall not include any reference within the assurance report to the engagement having been conducted in accordance with this HKSAE or any other HKSAE(s).

Limitation on Scope Prior to Acceptance of the Engagement

26. If the engaging party imposes a limitation on the scope of the practitioner's work in the terms of a proposed assurance engagement such that the practitioner believes the limitation will result in the practitioner disclaiming a conclusion on the subject matter information, the practitioner shall not accept such an engagement as an assurance engagement, unless required by law or regulation to do so. (Ref: Para. A156(c))

Agreeing on the Terms of the Engagement

27. The practitioner shall agree the terms of the engagement with the engaging party. The agreed terms of the engagement shall be specified in sufficient detail in an engagement letter or other suitable form of written agreement, written confirmation, or in law or regulation. (Ref: Para. A57–A58)

28. On recurring engagements, the practitioner shall assess whether circumstances require the terms of the engagement to be revised and whether there is a need to remind the engaging party of the existing terms of the engagement.

Acceptance of a Change in the Terms of the Engagement

29. The practitioner shall not agree to a change in the terms of the engagement where there is no reasonable justification for doing so. If such a change is made, the practitioner shall not disregard evidence that was obtained prior to the change. (Ref: Para. A59)

Assurance Report Prescribed by Law or Regulation

30. In some cases, law or regulation of the relevant jurisdiction prescribes the layout or wording of the assurance report. In these circumstances, the practitioner shall evaluate:

    (a) Whether intended users might misunderstand the assurance conclusion; and

    (b) If so, whether additional explanation in the assurance report can mitigate possible misunderstanding.

    If the practitioner concludes that additional explanation in the assurance report cannot mitigate possible misunderstanding, the practitioner shall not accept the engagement, unless required by law or regulation to do so. An engagement conducted in accordance with such law or regulation does not comply with HKSAEs. Accordingly, the practitioner shall not include any reference within the assurance report to the engagement having been conducted in accordance with this HKSAE or any other HKSAE(s) (see also paragraph 71).

Quality Control

Characteristics of the Engagement Partner

31. The engagement partner shall:

    (a) Be a member of a firm that applies HKSQC 1, or other professional requirements, or requirements in law or regulation, that are at least as demanding as HKSQC 1; (Ref: Para. A60–A66)

    (b) Have competence in assurance skills and techniques developed through extensive training and practical application; and (Ref: Para. A60)

    (c) Have sufficient competence in the underlying subject matter and its measurement or evaluation to accept responsibility for the assurance conclusion. (Ref: Para. A67–A68)

Assignment of the Team

32. The engagement partner shall: (Ref: Para. A69)

    (a) Be satisfied that those persons who are to perform the engagement collectively have the appropriate competence and capabilities to: (Ref: Para. A70–A71)

        (i) Perform the engagement in accordance with relevant standards and applicable legal and regulatory requirements; and

        (ii) Enable an assurance report that is appropriate in the circumstances to be issued.

    (b) Be satisfied that the practitioner will be able to be involved in the work of:

        (i) A practitioner's expert where the work of that expert is to be used; and (Ref: Para. A70–A71)

        (ii) Another practitioner, not part of the engagement team, where the assurance work of that practitioner is to be used, (Ref: Para. A72–A73)

    to an extent that is sufficient to accept responsibility for the assurance conclusion on the subject matter information.

Responsibilities of the Engagement Partner

33. The engagement partner shall take responsibility for the overall quality on the engagement. This includes responsibility for:

    (a) Appropriate procedures being performed regarding the acceptance and continuance of client relationships and engagements;

    (b) The engagement being planned and performed (including appropriate direction and supervision) to comply with professional standards and applicable legal and regulatory requirements;

    (c) Reviews being performed in accordance with the firm's review policies and procedures, and reviewing the engagement documentation on or before the date of the assurance report; (Ref: Para. A74)

    (d) Appropriate engagement documentation being maintained to provide evidence of achievement of the practitioner's objectives, and that the engagement was performed in accordance with relevant HKSAEs and relevant legal and regulatory requirements; and

    (e) Appropriate consultation being undertaken by the engagement team on difficult or contentious matters.

34. Throughout the engagement, the engagement partner shall remain alert, through observation and making inquiries as necessary, for evidence of non-compliance with relevant ethical requirements by members of the engagement team. If matters come to the engagement partner's attention through the firm's system of quality control or otherwise that indicate that members of the engagement team have not complied with relevant ethical requirements, the engagement partner, in consultation with others in the firm, shall determine the appropriate action.

35. The engagement partner shall consider the results of the firm's monitoring process as evidenced in the latest information circulated by the firm and, if applicable, other network firms and whether deficiencies noted in that information may affect the assurance engagement.

Engagement Quality Control Review

36. For those engagements, if any, for which a quality control review is required by law or regulation or for which the firm has determined that an engagement quality control review is required:

    (a) The engagement partner shall take responsibility for discussing significant matters arising during the engagement with the engagement quality control reviewer, and not date the assurance report until completion of that review; and

    (b) The engagement quality control reviewer shall perform an objective evaluation of the significant judgments made by the engagement team, and the conclusions reached in formulating the assurance report. This evaluation shall involve: (Ref: Para. A75)

        (i) Discussion of significant matters with the engagement partner;

        (ii) Review of the subject matter information and the proposed assurance report;

        (iii) Review of selected engagement documentation relating to the significant judgments the engagement team made and the conclusions it reached; and

        (iv) Evaluation of the conclusions reached in formulating the assurance report and consideration of whether the proposed assurance report is appropriate.

Professional Skepticism, Professional Judgment, and Assurance Skills and Techniques

37. The practitioner shall plan and perform an engagement with professional skepticism, recognizing that circumstances may exist that cause the subject matter information to be materiality misstated. (Ref: Para. A76–A80)

38. The practitioner shall exercise professional judgment in planning and performing an assurance engagement, including determining the nature, timing and extent of procedures. (Ref: Para. A81–A85)

39. The practitioner shall apply assurance skills and techniques as part of an iterative, systematic engagement process.

Planning and Performing the Engagement

Planning

40. The practitioner shall plan the engagement so that it will be performed in an effective manner, including setting the scope, timing and direction of the engagement, and determining the nature, timing and extent of planned procedures that are required to be carried out in order to achieve the objective of the practitioner. (Ref: Para. A86–A89)

41. The practitioner shall determine whether the criteria are suitable for the engagement circumstances, including that they exhibit the characteristics identified in paragraph 24(b)(ii).

42. If it is discovered after the engagement has been accepted that one or more preconditions for an assurance engagement is not present, the practitioner shall discuss the matter with the appropriate party(ies), and shall determine:

    (a) Whether the matter can be resolved to the practitioner's satisfaction;

    (b) Whether it is appropriate to continue with the engagement; and

    (c) Whether and, if so, how to communicate the matter in the assurance report.

43. If it is discovered after the engagement has been accepted that some or all of the applicable criteria are unsuitable or some or all of the underlying subject matter is not appropriate for an assurance engagement, the practitioner shall consider withdrawing from the engagement, if withdrawal is possible under applicable law or regulation. If the practitioner continues with the engagement, the practitioner shall express a qualified or adverse conclusion, or disclaimer of conclusion, as appropriate in the circumstances. (Ref: Para. A90–A91)

Materiality

44. The practitioner shall consider materiality when: (Ref: Para. A92–A100)

    (a) Planning and performing the assurance engagement, including when determining the nature, timing and extent of procedures; and

    (b) Evaluating whether the subject matter information is free from material misstatement.

Understanding the Underlying Subject Matter and Other Engagement Circumstances

45. The practitioner shall make inquiries of the appropriate party(ies) regarding:

    (a) Whether they have knowledge of any actual, suspected or alleged intentional misstatement or non-compliance with laws and regulations affecting the subject matter information; (Ref: Para. A101-A102)

    (b) Whether the responsible party has an internal audit function and, if so, make further inquiries to obtain an understanding of the activities and main findings of the internal audit function with respect to the subject matter information; and

    (c) Whether the responsible party has used any experts in the preparation of the subject matter information.

Limited Assurance	**Reasonable Assurance**
46L. The practitioner shall obtain an understanding of the underlying subject matter and other engagement circumstances sufficient to: (a) Enable the practitioner to identify areas where a material misstatement of the subject matter information is likely to arise; and (b) Thereby, provide a basis for designing and performing procedures to address the areas identified in paragraph 46L(a) and to obtain limited assurance to support the practitioner's conclusion. (Ref: Para. A101–A105, A108)	46R. The practitioner shall obtain an understanding of the underlying subject matter and other engagement circumstances sufficient to: (a) Enable the practitioner to identify and assess the risks of material misstatement in the subject matter information; and (b) Thereby, provide a basis for designing and performing procedures to respond to the assessed risks and to obtain reasonable assurance to support the practitioner's conclusion. (Ref: Para. A101–A104, A108)

47L. In obtaining an understanding of the underlying subject matter and other engagement circumstances under paragraph 46L, the practitioner shall consider the process used to prepare the subject matter information. (Ref: Para. A107)	47R. In obtaining an understanding of the underlying subject matter and other engagement circumstances under paragraph 46R, the practitioner shall obtain an understanding of internal control over the preparation of the subject matter information relevant to the engagement. This includes evaluating the design of those controls relevant to the engagement and determining whether they have been implemented by performing procedures in addition to inquiry of the personnel responsible for the subject matter information. (Ref: Para. A106)

Obtaining Evidence

Risk Consideration and Responses to Risks

Limited Assurance	Reasonable Assurance
48L. Based on the practitioner's understanding (see paragraph 46L), the practitioner shall: (Ref: Para. A109–A113) (a) Identify areas where a material misstatement of the subject matter information is likely to arise; and (b) Design and perform procedures to address the areas identified in paragraph 48L(a) and to obtain limited assurance to support the practitioner's conclusion.	48R. Based on the practitioner's understanding (see paragraph 46R) the practitioner shall: (Ref: Para. A109–A111) (a) Identify and assess the risks of material misstatement in the subject matter information; and (b) Design and perform procedures to respond to the assessed risks and to obtain reasonable assurance to support the practitioner's conclusion. In addition to any other procedures on the subject matter information that are appropriate in the engagement circumstances, the practitioner's procedures shall include obtaining sufficient appropriate evidence as to the operating effectiveness of relevant controls over the subject matter information when: (i) The practitioner's assessment of the risks of material misstatement includes an expectation that controls are operating effectively, or (ii) Procedures other than testing of controls cannot alone provide sufficient appropriate evidence.
Determining Whether Additional Procedures Are Necessary in a Limited Assurance Engagement 49L. If the practitioner becomes aware of a matter(s) that causes the practitioner to believe that the subject matter information may be materially misstated, the practitioner shall design and perform additional procedures to obtain further	Revision of Risk Assessment in a Reasonable Assurance Engagement 49R. The practitioner's assessment of the risks of material misstatement in the subject matter information may change during the course of the engagement as additional evidence is obtained. In circumstances where the practitioner obtains evidence that is

evidence until the practitioner is able to: (Ref: Para. A113–A118) (a) Conclude that the matter is not likely to cause the subject matter information to be materially misstated; or (b) Determine that the matter(s) causes the subject matter information to be materially misstated.	inconsistent with the evidence on which the practitioner originally based the assessment of the risks of material misstatement, the practitioner shall revise the assessment and modify the planned procedures accordingly. (Ref: Para. A113)

50. When designing and performing procedures, the practitioner shall consider the relevance and reliability of the information to be used as evidence. If:

    (a) Evidence obtained from one source is inconsistent with that obtained from another; or

    (b) The practitioner has doubts about the reliability of information to be used as evidence,

    the practitioner shall determine what changes or additions to procedures are necessary to resolve the matter, and shall consider the effect of the matter, if any, on other aspects of the engagement.

51. The practitioner shall accumulate uncorrected misstatements identified during the engagement other than those that are clearly trivial. (Ref: Para. A119–A120)

Work Performed by a Practitioner's Expert

52. When the work of a practitioner's expert is to be used, the practitioner shall also: (Ref: Para. A121–A125)

    (a) Evaluate whether the practitioner's expert has the necessary competence, capabilities and objectivity for the practitioner's purposes. In the case of a practitioner's external expert, the evaluation of objectivity shall include inquiry regarding interests and relationships that may create a threat to that expert's objectivity; (Ref: Para. A126–A129)

    (b) Obtain a sufficient understanding of the field of expertise of the practitioner's expert; (Ref: Para. A130–A131)

    (c) Agree with the practitioner's expert on the nature, scope and objectives of that expert's work; and (Ref: Para. A132–A133)

    (d) Evaluate the adequacy of the practitioner's expert's work for the practitioner's purposes. (Ref: Para. A134–A135)

Work Performed by Another Practitioner, a Responsible Party's or Measurer's or Evaluator's Expert, or an Internal Auditor (Ref: Para. A136)

53. When the work of another practitioner is to be used, the practitioner shall evaluate whether that work is adequate for the practitioner's purposes.

54. If information to be used as evidence has been prepared using the work of a responsible party's or a measurer's or evaluator's expert, the practitioner shall, to the extent necessary having regard to the significance of that expert's work for the practitioner's purposes:

    (a) Evaluate the competence, capabilities and objectivity of that expert;

    (b) Obtain an understanding of the work of that expert; and

    (c) Evaluate the appropriateness of that expert's work as evidence.

55. If the practitioner plans to use the work of the internal audit function, the practitioner shall evaluate the following:

    (a) The extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors;

    (b) The level of competence of the internal audit function;

    (c) Whether the internal audit function applies a systematic and disciplined approach, including quality control; and

    (d) Whether the work of the internal audit function is adequate for the purposes of the engagement.

Written Representations

56. The practitioner shall request from the appropriate party(ies) a written representation:

    (a) That it has provided the practitioner with all information of which the appropriate party(ies) is aware that is relevant to the engagement. (Ref: Para. A54–A55 and A137–A139)

    (b) Confirming the measurement or evaluation of the underlying subject matter against the applicable criteria, including that all relevant matters are reflected in the subject matter information.

57. If, in addition to required representations, the practitioner determines that it is necessary to obtain one or more written representations to support other evidence relevant to the subject matter information, the practitioner shall request such other written representations.

58. When written representations relate to matters that are material to the subject matter information, the practitioner shall:

    (a) Evaluate their reasonableness and consistency with other evidence obtained, including other representations (oral or written); and

    (b) Consider whether those making the representations can be expected to be well-informed on the particular matters.

59. The date of the written representations shall be as near as practicable to, but not after, the date of the assurance report.

Requested Written Representations Not Provided or Not Reliable

60. If one or more of the requested written representations are not provided or the practitioner concludes that there is sufficient doubt about the competence, integrity, ethical values, or diligence of those providing the written representations, or that the written representations are otherwise not reliable, the practitioner shall: (Ref: Para. A140)

    (a) Discuss the matter with the appropriate party(ies);

    (b) Reevaluate the integrity of those from whom the representations were requested or received and evaluate the effect that this may have on the reliability of representations (oral or written) and evidence in general; and

    (c) Take appropriate actions, including determining the possible effect on the conclusion in the assurance report.

Subsequent Events

61. When relevant to the engagement, the practitioner shall consider the effect on the subject matter information and on the assurance report of events up to the date of the assurance report, and shall respond appropriately to facts that become known to the practitioner after the date of the assurance report, that, had they been known to the practitioner at that date, may have caused the practitioner to amend the assurance report. The extent of consideration of subsequent events depends on the potential for such events to affect the subject matter information and to affect the appropriateness of the practitioner's conclusion. However, the practitioner has no responsibility to perform any procedures regarding the subject matter information after the date of the assurance report. (Ref: Para. A141–A142)

Other Information

62. When documents containing the subject matter information and the assurance report thereon include other information, the practitioner shall read that other information to identify material inconsistencies, if any, with the subject matter information or the assurance report and, if on reading that other information, the practitioner: (Ref: Para. A143)

    (a) Identifies a material inconsistency between that other information and the subject matter information or the assurance report; or

    (b) Becomes aware of a material misstatement of fact in that other information that is unrelated to matters appearing in the subject matter information or the assurance report,

    the practitioner shall discuss the matter with the appropriate party(ies) and take further action as appropriate.

Description of Applicable Criteria

63. The practitioner shall evaluate whether the subject matter information adequately refers to or describes the applicable criteria. (Ref: Para. A144–A146)

Forming the Assurance Conclusion

64. The practitioner shall evaluate the sufficiency and appropriateness of the evidence obtained in the context of the engagement and, if necessary in the circumstances, attempt to obtain further evidence. The practitioner shall consider all relevant evidence, regardless of whether it appears to corroborate or to contradict the measurement or evaluation of the underlying subject matter against the applicable criteria. If the practitioner is unable to obtain necessary further evidence, the practitioner shall consider the implications for the practitioner's conclusion in paragraph 65. (Ref: Para. A147–A153)

65. The practitioner shall form a conclusion about whether the subject matter information is free from material misstatement. In forming that conclusion, the practitioner shall consider the practitioner's conclusion in paragraph 64 regarding the sufficiency and appropriateness of evidence obtained and an evaluation of whether uncorrected misstatements are material, individually or in the aggregate. (Ref: Para. A3 and A154–A155)

66. If the practitioner is unable to obtain sufficient appropriate evidence, a scope limitation exists and the practitioner shall express a qualified conclusion, disclaim a conclusion, or withdraw from the engagement, where withdrawal is possible under applicable law or regulation, as appropriate. (Ref: Para. A156–A158)

Preparing the Assurance Report

67. The assurance report shall be in writing and shall contain a clear expression of the practitioner's conclusion about the subject matter information. (Ref: Para. A2, A159–A161)

68. The practitioner's conclusion shall be clearly separated from information or explanations that are not intended to affect the practitioner's conclusion, including any Emphasis of Matter, Other Matter, findings related to particular aspects of the engagements, recommendations or additional information included in the assurance report. The wording used shall make it clear that an Emphasis of Matter, Other Matter, findings, recommendations or additional information is not intended to detract from the practitioner's conclusion. (Ref: Para. A159–A161)

Assurance Report Content

69. The assurance report shall include, at a minimum, the following basic elements:

(a) A title that clearly indicates the report is an independent assurance report. (Ref: Para. A162)

(b) An addressee. (Ref: Para. A163)

(c) An identification or description of the level of assurance obtained by the practitioner, the subject matter information and, when appropriate, the underlying subject matter. When the practitioner's conclusion is phrased in terms of a statement made by the appropriate party, that statement shall accompany the assurance report, be reproduced in the assurance report or be referenced therein to a source that is available to the intended users. (Ref: Para A164)

(d) Identification of the applicable criteria. (Ref: Para. A165)

(e) Where appropriate, a description of any significant inherent limitations associated with the measurement or evaluation of the underlying subject matter against the applicable criteria. (Ref: Para. A166)

(f) When the applicable criteria are designed for a specific purpose, a statement alerting readers to this fact and that, as a result, the subject matter information may not be suitable for another purpose. (Ref: Para. A167–A168)

(g) A statement to identify the responsible party and the measurer or evaluator if different, and to describe their responsibilities and the practitioner's responsibilities. (Ref: Para. A169)

(h) A statement that the engagement was performed in accordance with this HKSAE or, where there is a subject-matter specific HKSAE, that HKSAE. (Ref: Para. A170–A171)

(i) A statement that the firm of which the practitioner is a member applies HKSQC 1, or other professional requirements, or requirements in law or regulation, that are at least as demanding as HKSQC 1. If the practitioner is not a professional accountant, the statement shall identify the professional requirements, or requirements in law or regulation, applied that are at least as demanding as HKSQC 1. (Ref: Para. A172)

(j) A statement that the practitioner complies with the independence and other ethical requirements of the Code, or other professional requirements, or requirements imposed by law or regulation, that are at least as demanding as Parts A, B and D of the Code related to assurance engagements. If the practitioner is not a professional accountant, the statement shall identify the professional requirements, or requirements imposed by law or regulation, applied that are at least as demanding as Parts A, B and D of the Code related to assurance engagements. (Ref: Para. A173)

(k) An informative summary of the work performed as the basis for the practitioner's conclusion. In the case of a limited assurance engagement, an appreciation of the nature, timing and extent of procedures performed is essential to understanding the practitioner's conclusion. In a limited assurance engagement, the summary of the work performed shall state that:

(i) The procedures performed in a limited assurance engagement vary in nature and timing from, and are less in extent than for, a reasonable assurance engagement; and

(ii) Consequently, the level of assurance obtained in a limited assurance engagement is substantially lower than the assurance that would have been obtained had a reasonable assurance engagement been performed. (Ref: Para. A6, A174–A178)

(l) The practitioner's conclusion: (Ref: Para. A2, A179–A181)

(i) When appropriate, the conclusion shall inform the intended users of the context in which the practitioner's conclusion is to be read. (Ref: Para. A180)

(ii) In a reasonable assurance engagement, the conclusion shall be expressed in a positive form. (Ref: Para. A179)

(iii) In a limited assurance engagement, the conclusion shall be expressed in a form that conveys whether, based on the procedures performed and evidence obtained, a matter(s) has come to the practitioner's attention to cause the practitioner to believe that the subject matter information is materially misstated. (Ref: Para. A181)

(iv) The conclusion in (ii) or (iii) shall be phrased using appropriate words for the underlying subject matter and applicable criteria given the engagement circumstances and shall be phrased in terms of: (Ref: Para. A182)

a. The underlying subject matter and the applicable criteria;

b. The subject matter information and the applicable criteria; or

c. A statement made by the appropriate party.

(v) When the practitioner expresses a modified conclusion, the assurance report shall contain:

a. A section that provides a description of the matter(s) giving rise to the modification; and

b. A section that contains the practitioner's modified conclusion. (Ref: Para. A183)

(m) The practitioner's signature. (Ref: Para. A184)

(n) The date of the assurance report. The assurance report shall be dated no earlier than the date on which the practitioner has obtained the evidence on which the practitioner's conclusion is based, including evidence that those with the recognized authority have asserted that they have taken responsibility for the subject matter information. (Ref: Para. A185)

(o) The location in the jurisdiction where the practitioner practices.

Reference to the Practitioner's Expert in the Assurance Report

70. If the practitioner refers to the work of a practitioner's expert in the assurance report, the wording of that report shall not imply that the practitioner's responsibility for the conclusion expressed in that report is reduced because of the involvement of that expert. (Ref: Para. A186–A188)

Assurance Report Prescribed by Law or Regulation

71. If the practitioner is required by law or regulation to use a specific layout or wording of the assurance report, the assurance report shall refer to this or other HKSAEs only if the assurance report includes, at a minimum, each of the elements identified in paragraph 69.

Unmodified and Modified Conclusions

72. The practitioner shall express an unmodified conclusion when the practitioner concludes:

    (a) In the case of a reasonable assurance engagement, that the subject matter information is prepared, in all material respects, in accordance with the applicable criteria; or

    (b) In the case of a limited assurance engagement, that, based on the procedures performed and evidence obtained, no matter(s) has come to the attention of the practitioner that causes the practitioner to believe that the subject matter information is not prepared, in all material respects, in accordance with the applicable criteria.

73. If the practitioner considers it necessary to:

    (a) Draw intended users' attention to a matter presented or disclosed in the subject matter information that, in the practitioner's judgment, is of such importance that it is fundamental to intended users' understanding of the subject matter information (an Emphasis of Matter paragraph); or

    (b) Communicate a matter other than those that are presented or disclosed in the subject matter information that, in the practitioner's judgment, is relevant to intended users' understanding of the engagement, the practitioner's responsibilities or the assurance report (an Other Matter paragraph),

    and this is not prohibited by law or regulation, the practitioner shall do so in a paragraph in the assurance report, with an appropriate heading, that clearly indicates the practitioner's conclusion is not modified in respect of the matter. In the case of an Emphasis of Matter paragraph, such a paragraph shall refer only to information presented or disclosed in the subject matter information.

74. The practitioner shall express a modified conclusion in the following circumstances:

    (a) When, in the practitioner's professional judgment, a scope limitation exists and the effect of the matter could be material (see paragraph 66). In such cases, the practitioner shall express a qualified conclusion or a disclaimer of conclusion.

    (b) When, in the practitioner's professional judgment, the subject matter information is materially misstated. In such cases, the practitioner shall express a qualified conclusion or adverse conclusion. (Ref: Para. A191)

75. The practitioner shall express a qualified conclusion when, in the practitioner's professional judgment, the effects, or possible effects, of a matter are not so material and pervasive as to require an adverse conclusion or a disclaimer of conclusion. A qualified conclusion shall be expressed as being "except for" the effects, or possible effects, of the matter to which the qualification relates. (Ref: Para. A189–A190)

76. If the practitioner expresses a modified conclusion because of a scope limitation but is also aware of a matter(s) that causes the subject matter information to be materially misstated, the practitioner shall include in the assurance report a clear description of both the scope limitation and the matter(s) that causes that the subject matter information to be materially misstated.

77. When the statement made by the appropriate party has identified and properly described that the subject matter information is materially misstated, the practitioner shall either:

(a) Express a qualified conclusion or adverse conclusion phrased in terms of the underlying subject matter and the applicable criteria; or

(b) If specifically required by the terms of the engagement to phrase the conclusion in terms of a statement made by the appropriate party, express an unqualified conclusion but include an Emphasis of Matter paragraph in the assurance report referring to the statement made by the appropriate party that identifies and properly describes that the subject matter information is materially misstated. (Ref: Para. A192)

Other Communication Responsibilities

78. The practitioner shall consider whether, pursuant to the terms of the engagement and other engagement circumstances, any matter has come to the attention of the practitioner that is to be communicated with the responsible party, the measurer or evaluator, the engaging party, those charged with governance or others. (Ref: Para. A193-A199)

Documentation

79. The practitioner shall prepare on a timely basis engagement documentation that provides a record of the basis for the assurance report that is sufficient and appropriate to enable an experienced practitioner, having no previous connection with the engagement, to understand: (Ref: Para. A200–A204)

(a) The nature, timing and extent of the procedures performed to comply with relevant HKSAEs and applicable legal and regulatory requirements;

(b) The results of the procedures performed, and the evidence obtained; and

(c) Significant matters arising during the engagement, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

80. If the practitioner identifies information that is inconsistent with the practitioner's final conclusion regarding a significant matter, the practitioner shall document how the practitioner addressed the inconsistency.

81. The practitioner shall assemble the engagement documentation in an engagement file and complete the administrative process of assembling the final engagement file on a timely basis after the date of the assurance report. (Ref: Para. A205–A206)

82. After the assembly of the final engagement file has been completed, the practitioner shall not delete or discard engagement documentation of any nature before the end of its retention period. (Ref: Para. A207)

83. If the practitioner finds it necessary to amend existing engagement documentation or add new engagement documentation after the assembly of the final engagement file has been completed the practitioner shall, regardless of the nature of the amendments or additions, document:

(a) The specific reasons for making the amendments or additions; and

(b) When, and by whom, they were made and reviewed.

Conformity and Compliance with International Standards on Assurance Engagements

84. As of March 2014 *(date of issue)*, this HKSAE conforms with International Standard on Assurance Engagements (ISAE) 3000 (Revised), "Assurance Engagements other than Audits or Reviews of Historical Financial Information". Compliance with the requirements of this HKSAE ensures compliance with ISAE 3000 (Revised).

85. Additional local guidance is provided in footnotes 1a, 3a and 7a.

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Application and Other Explanatory Material

Introduction (Ref: Para. 6)

A1. In a consulting engagement, the practitioner applies technical skills, education, observations, experiences, and knowledge. Consulting engagements involve an analytical process that typically involves some combination of activities relating to: objective-setting, fact-finding, definition of problems or opportunities, evaluation of alternatives, development of recommendations including actions, communication of results, and sometimes implementation and follow-up. Reports (if issued) are generally written in a narrative (or "long-form") style. Generally the work performed is only for the use and benefit of the client. The nature and scope of work is determined by agreement between the practitioner and the client. Any service that meets the definition of an assurance engagement is not a consulting engagement but an assurance engagement.

Objectives

Engagements with Subject Matter Information Comprising a Number of Aspects (Ref: Para. 10, 65, 69(l))

A2. Where the subject matter information is made up of a number of aspects, separate conclusions may be provided on each aspect. All such separate conclusions do not need to relate to the same level of assurance. Rather, each conclusion is expressed in the form that is appropriate to either a reasonable assurance engagement or a limited assurance engagement. References in this HKSAE to the conclusion in the assurance report include each conclusion when separate conclusions are provided.

Definitions

The Nature, Timing and Extent of Procedures in Limited and Reasonable Assurance Engagements (Ref: Para. 12(a)(i))

A3. Because the level of assurance obtained in a limited assurance engagement is lower than in a reasonable assurance engagement, the procedures the practitioner performs in a limited assurance engagement vary in nature and timing from, and are less in extent than for, a reasonable assurance engagement. The primary differences between the procedures for a reasonable assurance engagement and a limited assurance engagement include:

(a) The emphasis placed on the nature of various procedures as a source of evidence will likely differ, depending on the engagement circumstances. For example, the practitioner may judge it to be appropriate in the circumstances of a particular limited assurance engagement to place relatively greater emphasis on inquiries of the entity's personnel and analytical procedures, and relatively less emphasis, if any, on testing of controls and obtaining evidence from external sources than may be the case for a reasonable assurance engagement.

(b) In a limited assurance engagement the practitioner may:

- Select less items for examination; or

- Perform fewer procedures (for example, performing only analytical procedures in circumstances when, in a reasonable assurance engagement, both analytical procedures and other procedures would be performed).

(c) In a reasonable assurance engagement, analytical procedures performed in response to the engagement risk involve developing expectations that are sufficiently precise to identify material misstatements. In a limited assurance engagement, analytical procedures may be designed to support expectations regarding the direction of trends, relationships and ratios rather than to identify misstatements with the level of precision expected in a reasonable assurance engagement.

(d) Further, when significant fluctuations, relationships or differences are identified, appropriate evidence in a limited assurance engagement may be obtained by making inquiries and considering responses received in the light of known engagement circumstances.

(e) In addition, when undertaking analytical procedures in a limited assurance engagement the practitioner may, for example use data that is more highly aggregated, such as quarterly data rather than monthly data, or use data that has not been subjected to separate procedures to test its reliability to the same extent as it would be for a reasonable assurance engagement.

A Level of Assurance that is Meaningful (Ref: Para. 12(a)(i)(b), 47L)

A4. The level of assurance the practitioner plans to obtain is not ordinarily susceptible to quantification, and whether it is meaningful is a matter of professional judgment for the practitioner to determine in the circumstances of the engagement. In a limited assurance engagement, the practitioner performs procedures that are limited compared with those necessary in a reasonable assurance engagement but are, nonetheless, planned to obtain a level of assurance that is meaningful. To be meaningful the level of assurance obtained by the practitioner is likely to enhance the intended users' confidence about the subject matter information to a degree that is clearly more than inconsequential (see also paragraphs A16–A18).

A5. Across the range of all limited assurance engagements, what is meaningful assurance can vary from just above assurance that is likely to enhance the intended users' confidence about the subject matter information to a degree that is clearly more than inconsequential to just below reasonable assurance. What is meaningful in a particular engagement represents a judgment within that range that depends on the engagement circumstances, including the information needs of intended users as a group, the criteria, and the underlying subject matter of the engagement.

A6. Because the level of assurance obtained by the practitioner in limited assurance engagements varies, the practitioner's report contains an informative summary of the procedures performed, recognizing that an appreciation of the nature, timing and extent of procedures performed is essential to understanding the practitioner's conclusion (see paragraphs 69(k) and A173–A177).

A7. Some of the factors that may be relevant in determining what constitutes meaningful assurance in a specific engagement include, for example:

- The characteristics of the underlying subject matter and the criteria, and whether there are any relevant subject matter-specific HKSAEs.
- Instructions or other indications from the engaging party about the nature of the assurance the engaging party is seeking the practitioner to obtain. For example, the terms of the engagement may stipulate particular procedures that the engaging party considers necessary or particular aspects of the subject matter information on which the engaging party would like the practitioner to focus procedures. However, the practitioner may consider that other procedures are required to obtain sufficient appropriate evidence to obtain meaningful assurance.
- Generally accepted practice, if it exists, with respect to assurance engagements for the particular subject matter information, or similar or related subject matter information.

- The information needs of intended users as a group. Generally, the greater the consequence to intended users of receiving an inappropriate conclusion when the subject matter information is materially misstated, the greater the assurance that would be needed in order to be meaningful to them. For example, in some cases, the consequence to intended users of receiving an inappropriate conclusion may be so great that a reasonable assurance engagement is needed for the practitioner to obtain assurance that is meaningful in the circumstances.

- The expectation by intended users that the practitioner will form the limited assurance conclusion on the subject matter information within a short timeframe and at a low cost.

Examples of Attestation Engagements (Ref: Para. 12(a)(ii)(a))

A8. Examples of engagements that may be conducted under this HKSAE include:

(a) Sustainability – An engagement on sustainability involves obtaining assurance on a report prepared by management or management's expert (the measurer or evaluator) on the sustainability performance of the entity.

(b) Compliance with law or regulation – An engagement on compliance with law or regulation involves obtaining assurance on a statement by another party (the measurer or evaluator) of compliance with the relevant law or regulation.

(c) Value for money – An engagement on value for money involves obtaining assurance on a measurement or evaluation of value for money by another party (the measurer or evaluator).

Assurance Skills and Techniques (Ref: Para. 12(b))

A9. Assurance skills and techniques include:

- Application of professional skepticism and professional judgment;

- Planning and performing an assurance engagement, including obtaining and evaluating evidence;

- Understanding information systems and the role and limitations of internal control;

- Linking the consideration of materiality and engagement risks to the nature, timing and extent of procedures;

- Applying procedures as appropriate to the engagement (which may include inquiry, inspection, recalculation, reperformance, observation, confirmation, and analytical procedures); and

- Systematic documentation practices and assurance report-writing skills.

Criteria (Ref: Para. 12(c), Appendix)

A10. Suitable criteria are required for reasonably consistent measurement or evaluation of an underlying subject matter within the context of professional judgment. Without the frame of reference provided by suitable criteria, any conclusion is open to individual interpretation and misunderstanding. The suitability of criteria is context-sensitive, that is, it is determined in the context of the engagement circumstances. Even for the same underlying subject matter there can be different criteria, which will yield a different measurement or evaluation. For example, a measurer or evaluator might select, as one of the criteria for the underlying subject matter of customer satisfaction, the number of customer complaints resolved to the acknowledged satisfaction of the customer; another measurer or evaluator might select the number of repeat purchases in the three months following the initial purchase. The suitability of criteria is not affected by the level of assurance, that is, if criteria are unsuitable for a reasonable assurance engagement, they are also unsuitable for a limited assurance engagement, and vice versa. Suitable criteria include, when relevant, criteria for presentation and disclosure.

Engagement Risk (Ref: Para. 12(f))

A11. Engagement risk does not refer to, or include, the practitioner's business risks, such as loss from litigation, adverse publicity, or other events arising in connection with particular subject matter information.

A12. In general, engagement risk can be represented by the following components, although not all of these components will necessarily be present or significant for all assurance engagements:

(a) Risks that the practitioner does not directly influence, which in turn consist of:

(i) The susceptibility of the subject matter information to a material misstatement before consideration of any related controls applied by the appropriate party(ies) (inherent risk); and

(ii) The risk that a material misstatement that occurs in the subject matter information will not be prevented, or detected and corrected, on a timely basis by the appropriate party(ies)'s internal control (control risk); and

(b) The risk that the practitioner does directly influence, which is the risk that the procedures performed by the practitioner will not detect a material misstatement (detection risk).

A13. The degree to which each of these components is relevant to the engagement is affected by the engagement circumstances, in particular:

- The nature of the underlying subject matter and the subject matter information. For example, the concept of control risk may be more useful when the underlying subject matter relates to the preparation of information about an entity's performance than when it relates to information about the effectiveness of a control or the existence of a physical condition.

- Whether a reasonable assurance or a limited assurance engagement is being performed. For example, in limited assurance engagements the practitioner may often decide to obtain evidence by means other than testing of controls, in which case consideration of control risk may be less relevant than in a reasonable assurance engagement on the same subject matter information.

The consideration of risks is a matter of professional judgment, rather than a matter capable of precise measurement.

A14. Reducing engagement risk to zero is very rarely attainable or cost beneficial and, therefore, "reasonable assurance" is less than absolute assurance, as a result of factors such as the following:

- The use of selective testing.

- The inherent limitations of internal control.

- The fact that much of the evidence available to the practitioner is persuasive rather than conclusive.

- The use of professional judgment in gathering and evaluating evidence and forming conclusions based on that evidence.

- In some cases, the characteristics of the underlying subject matter when evaluated or measured against the criteria.

The Engaging Party (Ref: Para. 12(g), Appendix)

A15. The engaging party may be, under different circumstances, management or those charged with governance of the responsible party, a legislature, the intended users, the measurer or evaluator, or a different third party.

Intended Users (Ref: Para. 12(m), Appendix)

A16. In some cases, there may be intended users other than those to whom the assurance report is addressed. The practitioner may not be able to identify all those who will read the assurance report, particularly where a large number of people have access to it. In such cases, particularly where possible users are likely to have a broad range of interests in the underlying subject matter, intended users may be limited to major stakeholders with significant and common interests. Intended users may be identified in different ways, for example, by agreement between the practitioner and the responsible party or engaging party, or by law or regulation.

A17. Intended users or their representatives may be directly involved with the practitioner and the responsible party (and the engaging party if different) in determining the requirements of the engagement. Regardless of the involvement of others however, and unlike an agreed-upon procedures engagement (which involves reporting factual findings based upon procedures agreed with the engaging party and any appropriate third parties, rather than a conclusion):

(a) The practitioner is responsible for determining the nature, timing and extent of procedures; and

(b) The practitioner may need to perform additional procedures if information comes to the practitioner's attention that differs significantly from that on which the determination of planned procedures was based (see paragraphs A116–A118).

A18. In some cases, intended users (for example, bankers and regulators) impose a requirement on, or request the appropriate party(ies) to arrange for an assurance engagement to be performed for a specific purpose. When engagements use criteria that are designed for a specific purpose, paragraph 69(f) requires a statement alerting readers to this fact. In addition, the practitioner may consider it appropriate to indicate that the assurance report is intended solely for specific users. Depending on the engagement circumstances, this may be achieved by restricting the distribution or use of the assurance report (see paragraphs A167–A168).

Subject Matter Information (Ref: Para. 12(x), Appendix)

A19. In some cases, the subject matter information may be a statement that evaluates an aspect of a process, or of performance or compliance, in relation to the criteria. For example, "ABC's internal control operated effectively in terms of XYZ criteria during the period …." or "ABC's governance structure conformed with XYZ criteria during the period …".

The Appropriate Party(ies) (Ref: Para. 13, Appendix)

A20. The roles played by the responsible party, the measurer or evaluator, and the engaging party can vary (see paragraph A37). Also, management and governance structures vary by jurisdiction and by entity, reflecting influences such as different cultural and legal backgrounds, and size and ownership characteristics. Such diversity means that it is not possible for HKSAEs to specify for all engagements the person(s) with whom the practitioner is to inquire of, request representations from, or otherwise communicate with in all circumstances. In some cases, for example, when the appropriate party(ies) is only part of a complete legal entity, identifying the appropriate management personnel or those charged with governance with whom to communicate will require the exercise of professional judgment to determine which person(s) have the appropriate responsibilities for, and knowledge of, the matters concerned.

Conduct of an Assurance Engagement in Accordance with HKSAEs

Complying with Standards that Are Relevant to the Engagement (Ref: Para. 1, 5, 15)

A21. This HKSAE includes requirements that apply to assurance engagements[3] (other than audits or reviews of historical financial information), including engagements in accordance with a subject matter-specific HKSAE. In some cases, a subject matter-specific HKSAE is also relevant to the engagement. A subject matter-specific HKSAE is relevant to the engagement when the HKSAE is in effect, the subject matter of the HKSAE is relevant to the engagement, and the circumstances addressed by the HKSAE exist.

A22. The HKSAs and HKSREs have been written for audits and reviews of historical financial information, respectively, and do not apply to other assurance engagements. They may, however, provide guidance in relation to the engagement process generally for practitioners undertaking an assurance engagement in accordance with this HKSAE.

Text of an HKSAE (Ref: Para. 12, 16)

A23. HKSAEs contain the objectives of the practitioner in following the HKSAEs, and requirements designed to enable the practitioner to meet those objectives. In addition, they contain related guidance in the form of application and other explanatory material, introductory material that provides context relevant to a proper understanding of the HKSAE, and definitions.

A24. The objectives in an HKSAE provide the context in which the requirements of the HKSAE are set, and are intended to assist in:

(a) Understanding what is to be accomplished; and

(b) Deciding whether more needs to be done to achieve the objectives.

The proper application of the requirements of an HKSAE by the practitioner is expected to provide a sufficient basis for the practitioner's achievement of the objectives. However, because the circumstances of assurance engagements vary widely and all such circumstances cannot be anticipated in the HKSAEs, the practitioner is responsible for determining the procedures necessary to fulfill the requirements of relevant HKSAEs and to achieve the objectives stated therein. In the circumstances of an engagement, there may be particular matters that require the practitioner to perform procedures in addition to those required by relevant HKSAEs to meet the objectives specified in those HKSAEs.

A25. The requirements of HKSAEs are expressed using "shall."

A26. Where necessary, the application and other explanatory material provides further explanation of the requirements and guidance for carrying them out. In particular, it may:

(a) Explain more precisely what a requirement means or is intended to cover; and

(b) Include examples that may be appropriate in the circumstances.

While such guidance does not in itself impose a requirement, it is relevant to the proper application of the requirements. The application and other explanatory material may also provide background information on matters addressed in an HKSAE. Where appropriate, additional considerations specific to public sector audit organizations or smaller firms are included within the application and other explanatory material. These additional considerations assist in the application of the requirements in the HKSAEs. They do not, however, limit or reduce the responsibility of the practitioner to apply and comply with the requirements in an HKSAE.

[3] This HKSAE contains requirements and application and other explanatory material specific to reasonable and limited assurance attestation engagements. This HKSAE may also be applied to reasonable and limited assurance direct engagements, adapted and supplemented as necessary in the engagement circumstances.

A27. Definitions are provided in the HKSAEs to assist in the consistent application and interpretation of the HKSAEs, and are not intended to override definitions that may be established for other purposes, whether by laws, regulations or otherwise.

A28. Appendices form part of the application and other explanatory material. The purpose and intended use of an appendix are explained in the body of the related HKSAE or within the title and introduction of the appendix itself.

Complying with Relevant Requirements (Ref: Para. 17)

A29. Although some procedures are required only for reasonable assurance engagements, they may nonetheless be appropriate in some limited assurance engagements.

Ethical Requirements (Ref: Para. 3(a), 20, 22(a))

A30. Part A of the Code establishes the following fundamental principles with which the practitioner is required to comply:

(a) Integrity;

(b) Objectivity;

(c) Professional competence and due care;

(d) Confidentiality; and

(e) Professional behavior.

A31. Part A of the Code also provides a conceptual framework for professional accountants to apply to:

(a) Identify threats to compliance with the fundamental principles. Threats fall into one or more of the following categories:

(i) Self-interest;

(ii) Self-review;

(iii) Advocacy;

(iv) Familiarity; and

(v) Intimidation;

(b) Evaluate the significance of the threats identified; and

(c) Apply safeguards, when necessary, to eliminate the threats or reduce them to an acceptable level. Safeguards are necessary when the professional accountant determines that the threats are not at a level at which a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances available to the professional accountant at that time, that compliance with the fundamental principles is not compromised.

A32. Part B of the Code describes how the conceptual framework in Part A applies in certain situations to professional accountants in public practice, including:

- Professional appointment;
- Conflicts of interest;

- Second opinions;
- Fees and other types of remuneration;
- Marketing professional services;
- Gifts and hospitality;
- Custody of client assets;
- Objectivity; and
- Independence.

A33. The Code defines independence as comprising both independence of mind and independence in appearance. Independence safeguards the ability to form an assurance conclusion without being affected by influences that might compromise that conclusion. Independence enhances the ability to act with integrity, to be objective and to maintain an attitude of professional skepticism. Matters addressed in the Code with respect to independence include:

- Financial interests;
- Loans and guarantees;
- Business relationships;
- Family and personal relationships;
- Employment with assurance clients;
- Recent service with an assurance client;
- Serving as a director or officer of an assurance client;
- Long association of senior personnel with assurance clients;
- Provision of non-assurance services to assurance clients;
- Fees (relative size, overdue, and contingent fees);
- Gifts and hospitality; and
- Actual or threatened litigation.

A34. Professional requirements, or requirements imposed by law or regulation, are at least as demanding as Parts A, B and D of the Code related to assurance engagements when they address all the matters referred to in paragraphs A30–A33 and impose obligations that achieve the aims of the requirements set out in Parts A, B and D of the Code related to assurance engagements.

Acceptance and Continuance

Preconditions for the Engagement (Ref: Para. 24)

A35. In a public sector environment, some of the preconditions for an assurance engagement may be assumed to be present, for example:

(a) The roles and responsibilities of public sector audit organizations and the government entities scoped into assurance engagements are assumed to be appropriate because they are generally set out in legislation;

(b) Public sector audit organizations' right of access to the information necessary to perform the engagement is often set out in legislation;

(c) The practitioner's conclusion, in the form appropriate to either a reasonable assurance engagement or a limited assurance engagement, is generally required by legislation to be contained in a written report; and

(d) A rational purpose is generally present because the engagement is set out in legislation.

A36. If suitable criteria are not available for all of the underlying subject matter but the practitioner can identify one or more aspects of the underlying subject matter for which those criteria are suitable, then an assurance engagement can be performed with respect to that aspect of the underlying subject matter in its own right. In such cases, the assurance report may need to clarify that the report does not relate to the original underlying subject matter in its entirety.

Roles and Responsibilities (Ref: Para. 12(m), 12(n), 12(r), 12(v), 13, 24(a), Appendix)

A37. All assurance engagements have at least three parties: the responsible party, the practitioner, and the intended users. In many attestation engagements, the responsible party may also be the measurer or evaluator, and the engaging party. See the Appendix for a discussion of how each of these roles relate to an assurance engagement.

A38. Evidence that the appropriate relationship exists with respect to responsibility for the underlying subject matter may be obtained through an acknowledgement provided by the responsible party. Such an acknowledgement also establishes a basis for a common understanding of the responsibilities of the responsible party and the practitioner. A written acknowledgement is the most appropriate form of documenting the responsible party's understanding. In the absence of a written acknowledgement of responsibility, it may still be appropriate for the practitioner to accept the engagement if, for example, other sources, such as legislation or a contract, indicate responsibility. In other cases, it may be appropriate to decline the engagement depending on the circumstances, or to disclose the circumstances in the assurance report.

A39. The measurer or evaluator is responsible for having a reasonable basis for the subject matter information. What constitutes a reasonable basis will depend on the nature of the underlying subject matter and other engagement circumstances. In some cases, a formal process with extensive internal controls may be needed to provide the measurer or evaluator with a reasonable basis that the subject matter information is free from material misstatement. The fact that the practitioner will report on the subject matter information is not a substitute for the measurer or evaluator's own processes to have a reasonable basis for the subject matter information.

Appropriateness of the Underlying Subject Matter (Ref: Para. 24(b)(i))

A40. An appropriate underlying subject matter is identifiable and capable of consistent measurement or evaluation against the applicable criteria such that the resulting subject matter information can be subjected to procedures for obtaining sufficient appropriate evidence to support a reasonable assurance or limited assurance conclusion, as appropriate.

A41. The appropriateness of an underlying subject matter is not affected by the level of assurance, that is, if an underlying subject matter is not appropriate for a reasonable assurance engagement, it is also not appropriate for a limited assurance engagement, and vice versa.

A42. Different underlying subject matters have different characteristics, including the degree to which information about them is qualitative versus quantitative, objective versus subjective, historical versus prospective, and relates to a point in time or covers a period. Such characteristics affect the:

(a) Precision with which the underlying subject matter can be measured or evaluated against criteria; and

(b) The persuasiveness of available evidence.

A43. Identifying such characteristics and considering their effects assist the practitioner when assessing the appropriateness of the underlying subject matter and also in determining the content of the assurance report (see paragraph A163).

A44. In some cases, the assurance engagement may relate to only one part of a broader underlying subject matter. For example, the practitioner may be engaged to report on one aspect of an entity's contribution to sustainable development, such as a number of programs run by an entity that have positive environmental outcomes. In determining whether the engagement exhibits the characteristic of having an appropriate underlying subject matter in such cases, it may be appropriate for the practitioner to consider whether information about the aspect on which the practitioner is asked to report is likely to meet the information needs of intended users as a group, and also how the subject matter information will be presented and distributed, for example, whether there are more significant programs with less favorable outcomes that the entity is not reporting upon.

Suitability and Availability of the Criteria

Suitability of the criteria (Ref: Para. 24(b)(ii))

A45. Suitable criteria exhibit the following characteristics:

(a) Relevance: Relevant criteria result in subject matter information that assists decision-making by the intended users.

(b) Completeness: Criteria are complete when subject matter information prepared in accordance with them does not omit relevant factors that could reasonably be expected to affect decisions of the intended users made on the basis of that subject matter information. Complete criteria include, where relevant, benchmarks for presentation and disclosure.

(c) Reliability: Reliable criteria allow reasonably consistent measurement or evaluation of the underlying subject matter including, where relevant, presentation and disclosure, when used in similar circumstances by different practitioners.

(d) Neutrality: Neutral criteria result in subject matter information that is free from bias as appropriate in the engagement circumstances.

(e) Understandability: Understandable criteria result in subject matter information that can be understood by the intended users.

A46. Vague descriptions of expectations or judgments of an individual's experiences do not constitute suitable criteria.

A47. The suitability of criteria for a particular engagement depends on whether they reflect the above characteristics. The relative importance of each characteristic to a particular engagement is a matter of professional judgment. Further, criteria may be suitable for a particular set of engagement circumstances, but may not be suitable for a different set of engagement circumstances. For example, reporting to governments or regulators may require the use of a particular set of criteria, but these criteria may not be suitable for a broader group of users.

A48. Criteria can be selected or developed in a variety of ways, for example, they may be:

- Embodied in law or regulation.

- Issued by authorized or recognized bodies of experts that follow a transparent due process.

- Developed collectively by a group that does not follow a transparent due process.
- Published in scholarly journals or books.
- Developed for sale on a proprietary basis.
- Specifically designed for the purpose of preparing the subject matter information in the particular circumstances of the engagement.

How criteria are developed may affect the work that the practitioner carries out to assess their suitability.

A49. In some cases, law or regulation prescribes the criteria to be used for the engagement. In the absence of indications to the contrary, such criteria are presumed to be suitable, as are criteria issued by authorized or recognized bodies of experts that follow a transparent due process if they are relevant to the intended users' information needs. Such criteria are known as established criteria. Even when established criteria exist for an underlying subject matter, specific users may agree to other criteria for their specific purposes. For example, various frameworks can be used as established criteria for evaluating the effectiveness of internal control. Specific users may, however, develop a more detailed set of criteria that meet their specific information needs in relation to, for example, prudential supervision. In such cases, the assurance report:

(a) Alerts readers that the subject matter information is prepared in accordance with special purpose criteria and that, as a result, the subject matter information may not be suitable for another purpose (see paragraph 69(f)); and

(b) May note, when it is relevant to the circumstances of the engagement, that the criteria are not embodied in law or regulation, or issued by authorized or recognized bodies of experts that follow a transparent due process.

A50. If criteria are specifically designed for the purpose of preparing the subject matter information in the particular circumstances of the engagement, they are not suitable if they result in subject matter information or an assurance report that is misleading to the intended users. It is desirable for the intended users or the engaging party to acknowledge that specifically developed criteria are suitable for the intended users' purposes. The absence of such an acknowledgement may affect what is to be done to assess the suitability of the criteria, and the information provided about the criteria in the assurance report.

Availability of the criteria (Ref: Para. 24(b)(iii))

A51. Criteria need to be available to the intended users to allow them to understand how the underlying subject matter has been measured or evaluated. Criteria are made available to the intended users in one or more of the following ways:

(a) Publicly.

(b) Through inclusion in a clear manner in the presentation of the subject matter information.

(c) Through inclusion in a clear manner in the assurance report (see paragraph A165).

(d) By general understanding, for example the criterion for measuring time in hours and minutes.

A52. Criteria may also be available only to intended users, for example the terms of a contract, or criteria issued by an industry association that are available only to those in the industry because they are relevant only to a specific purpose. When this is the case, paragraph 69(f) requires a statement alerting readers to this fact. In addition, the practitioner may consider it appropriate to indicate that the assurance report is intended solely for specific users (see paragraph A167–A168).

Access to Evidence (Ref: Para. 24(b)(iv))

Quantity and quality of available evidence

A53. The quantity or quality of available evidence is affected by:

(a) The characteristics of the underlying subject matter or the subject matter information. For example, less objective evidence might be expected when the subject matter information is future oriented rather than historical; and

(b) Other circumstances, such as when evidence that could reasonably be expected to exist is not available because of, for example, the timing of the practitioner's appointment, an entity's document retention policy, inadequate information systems, or a restriction imposed by the responsible party.

Ordinarily, evidence will be persuasive rather than conclusive.

Access to records (Ref: Para. 56)

A54. Seeking the agreement of the appropriate party(ies) that it acknowledges and understands its responsibility to provide the practitioner with the following may assist the practitioner in determining whether the engagement exhibits the characteristic of access to evidence:

(a) Access to all information of which the appropriate party(ies) is aware that is relevant to the preparation of the subject matter information such as records, documentation and other matters;

(b) Additional information that the practitioner may request from the appropriate party(ies) for the purpose of the engagement; and

(c) Unrestricted access to persons from the appropriate party(ies) from whom the practitioner determines it necessary to obtain evidence.

A55. The nature of relationships between the responsible party, the measurer or evaluator, and the engaging party may affect the practitioner's ability to access records, documentation and other information the practitioner may require as evidence to complete the engagement. The nature of such relationships may therefore be a relevant consideration when determining whether or not to accept the engagement. Examples of some circumstances in which the nature of these relationships may be problematic are included in paragraph A140.

A Rational Purpose (Ref: Para. 24(b)(vi))

A56. In determining whether the engagement has a rational purpose, relevant considerations may include the following:

- The intended users of the subject matter information and the assurance report (particularly, when the criteria are designed for a special purpose). A further consideration is the likelihood that the subject matter information and the assurance report will be used or distributed more broadly than to intended users.

- Whether aspects of the subject matter information are expected to be excluded from the assurance engagement, and the reason for their exclusion.

- The characteristics of the relationships between the responsible party, the measurer or evaluator, and the engaging party, for example, when the measurer or evaluator is not the responsible party, whether the responsible party consents to the use to be made of the subject matter information and will have the opportunity to review the subject matter information before it is made available to intended users or to distribute comments with the subject matter information.

- Who selected the criteria to be applied to measure or evaluate the underlying subject matter, and what the degree of judgment and scope for bias is in applying them. The engagement is more likely to have a rational purpose if the intended users selected or were involved in selecting the criteria.

- Any significant limitations on the scope of the practitioner's work.

- Whether the practitioner believes the engaging party intends to associate the practitioner's name with the underlying subject matter or the subject matter information in an inappropriate manner.

Agreeing on the Terms of the Engagement (Ref: Para. 27)

A57. It is in the interests of both the engaging party and the practitioner that the practitioner communicates in writing the agreed terms of the engagement before the commencement of the engagement to help avoid misunderstandings. The form and content of the written agreement or contract will vary with the engagement circumstances. For example, if law or regulation prescribes in sufficient detail the terms of the engagement, the practitioner need not record them in a written agreement, except for the fact that such law or regulation applies and that the appropriate party acknowledges and understands its responsibilities under such law or regulation.

A58. Law or regulation, particularly in the public sector, may mandate the appointment of a practitioner and set out specific powers, such as the power to access an appropriate party(ies)'s records and other information, and responsibilities, such as requiring the practitioner to report directly to a minister, the legislature or the public if an appropriate party(ies) attempts to limit the scope of the engagement.

Acceptance of a Change in the Terms of the Engagement (Ref: Para. 29)

A59. A change in circumstances that affects the intended users' requirements, or a misunderstanding concerning the nature of the engagement, may justify a request for a change in the engagement, for example, from an assurance engagement to a non-assurance engagement, or from a reasonable assurance engagement to a limited assurance engagement. An inability to obtain sufficient appropriate evidence to form a reasonable assurance conclusion is not an acceptable reason to change from a reasonable assurance engagement to a limited assurance engagement.

Quality Control

Professional Accountants in Public Practice (Ref: Para. 20, 31(a)–(b))

A60. This HKSAE has been written in the context of a range of measures taken to ensure the quality of assurance engagements undertaken by professional accountants in public practice, such as those taken by IFAC member bodies[3a] in accordance with IFAC's Member Body Compliance Program and Statements of Membership Obligations. Such measures include:

- Competency requirements, such as education and experience benchmarks for entry to membership, and ongoing continuing professional development as well as life-long learning requirements.

- Quality control policies and procedures implemented across the firm. HKSQC 1 applies to all firms of professional accountants in respect of assurance and related services engagements.

- A comprehensive Code, including detailed independence requirements, founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

[3a] The Hong Kong Institute of Certified Public Accountants is a member of IFAC.

Firm Level Quality Control (Ref: Para. 3(b), 31(a))

A61. HKSQC 1 deals with the firm's responsibilities to establish and maintain its system of quality control for assurance engagements. It sets out the responsibilities of the firm for establishing policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements, including those pertaining to independence. Compliance with HKSQC 1 requires, among other things, that the firm establish and maintain a system of quality control that includes policies and procedures addressing each of the following elements, and that it documents its policies and procedures and communicates them to the firm's personnel:

(a) Leadership responsibilities for quality within the firm;

(b) Relevant ethical requirements;

(c) Acceptance and continuance of client relationships and specific engagements;

(d) Human resources;

(e) Engagement performance; and

(f) Monitoring.

A62. Other professional requirements, or requirements in law or regulation that deal with the firm's responsibilities to establish and maintain a system of quality control, are at least as demanding as HKSQC 1 when they address all the matters referred to in the preceding paragraph and impose obligations on the firm that achieve the aims of the requirements set out in HKSQC 1.

A63. The actions of the engagement partner, and appropriate messages to the other members of the engagement team, in the context of the engagement partner taking responsibility for the overall quality on each engagement, emphasize the fact that quality is essential in performing an assurance engagement, and the importance to the quality of the assurance engagement of:

(a) Performing work that complies with professional standards and regulatory and legal requirements.

(b) Complying with the firm's quality control policies and procedures as applicable.

(c) Issuing a report for the engagement that is appropriate in the circumstances.

(d) The engagement team's ability to raise concerns without fear of reprisals.

A64. An effective system of quality control includes a monitoring process designed to provide the firm with reasonable assurance that its policies and procedures relating to the system of quality control are relevant, adequate and operating effectively.

A65. Unless information provided by the firm or other parties suggests otherwise, the engagement team is entitled to rely on the firm's system of quality control. For example, the engagement team may rely on the firm's system of quality control in relation to:

(a) Competence of personnel through their recruitment and formal training.

(b) Independence through the accumulation and communication of relevant independence information.

(c) Maintenance of client relationships through acceptance and continuance systems.

(d) Adherence to regulatory and legal requirements through the monitoring process.

In considering deficiencies identified in the firm's system of quality control that may affect the assurance engagement, the engagement partner may consider measures taken by the firm to rectify those deficiencies.

A66. A deficiency in the firm's system of quality control does not necessarily indicate that an assurance engagement was not performed in accordance with professional standards and applicable legal and regulatory requirements, or that the practitioner's report was not appropriate.

Skills, Knowledge and Experience with Respect to the Underlying Subject Matter and Its Measurement or Evaluation (Ref: Para. 31(c))

A67. A practitioner may be requested to perform assurance engagements with respect to a wide range of underlying subject matter and subject matter information. Some may require specialized skills and knowledge beyond those ordinarily possessed by a particular individual.

A68. The Code requires the professional accountant in public practice to agree to provide only those services that the professional accountant in public practice is competent to perform. [4] The practitioner has sole responsibility for the assurance conclusion expressed, and that responsibility is not reduced by the practitioner's use of the work of a practitioner's expert. Nonetheless, if the practitioner using the work of a practitioner's expert, having followed this HKSAE, concludes that the work of that expert is adequate for the practitioner's purposes, the practitioner may accept that expert's findings or conclusions in the expert's field as appropriate evidence.

Assignment of the Team

Collective Competence and Capabilities (Ref: Para. 32)

A69. HKSQC 1 requires the firm to establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide the firm with reasonable assurance that it will only undertake or continue relationships and engagements where the firm is competent to perform the engagement and has the capabilities, including time and resources, to do so.[5]

Practitioner's Expert (Ref: Para. 32(a), 32(b)(i))

A70. Some of the assurance work may be performed by a multi-disciplinary team that includes one or more practitioner's expert. For example, a practitioner's expert may be needed to assist the practitioner in obtaining an understanding of the underlying subject matter and other engagement circumstances or in one or more of the matters mentioned in paragraph 46R (in the case of a reasonable assurance engagement) or 46L (in the case of a limited assurance engagement).

A71. When the work of a practitioner's expert is to be used, it may be appropriate to perform some of the procedures required by paragraph 52 at the engagement acceptance or continuance stage.

Other Practitioners (Ref: Para. 32(b)(ii))

A72. The subject matter information may include information upon which another practitioner may have expressed a conclusion. The practitioner, in concluding on the subject matter information, may decide to use the evidence on which that other practitioner's conclusion is based to provide evidence regarding the subject matter information.

A73. The work of another practitioner may be used in relation to, for example, an underlying subject matter at a remote location or in a foreign jurisdiction. Such other practitioners are not part of the engagement team. Relevant considerations when the engagement team plans to use the work of another practitioner may include:

[4] The Code, paragraph 210.6
[5] HKSQC 1, paragraph 26

- Whether the other practitioner understands and complies with the ethical requirements that are relevant to the engagement and, in particular, is independent.

- The other practitioner's professional competence.

- The extent of the engagement team's involvement in the work of the other practitioner.

- Whether the other practitioner operates in a regulatory environment that actively oversees that practitioner.

Review Responsibilities (Ref: Para. 33(c))

A74. Under HKSQC 1, the firm's review responsibility policies and procedures are determined on the basis that the work of less experienced team members is reviewed by more experienced team members.[6]

Engagement Quality Control Review (Ref: Para. 36(b))

A75. Other matters that may be considered in an engagement quality control review include:

(a) The engagement team's evaluation of the firm's independence in relation to the engagement;

(b) Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations; and

(c) Whether engagement documentation selected for review reflects the work performed in relation to the significant judgments and supports the conclusions reached.

Professional Skepticism and Professional Judgment

Professional Skepticism (Ref: Para. 37)

A76. Professional skepticism is an attitude that includes being alert to, for example:

- Evidence that is inconsistent with other evidence obtained.

- Information that calls into question the reliability of documents and responses to inquiries to be used as evidence.

- Circumstances that suggest the need for procedures in addition to those required by relevant HKSAEs.

- Conditions that may indicate likely misstatement.

A77. Maintaining professional skepticism throughout the engagement is necessary if the practitioner is, for example, to reduce the risks of:

- Overlooking unusual circumstances.

- Overgeneralizing when drawing conclusions from observations.

- Using inappropriate assumptions in determining the nature, timing and extent of the procedures, and evaluating the results thereof.

[6] HKSQC 1, paragraph 33

A78. Professional skepticism is necessary to the critical assessment of evidence. This includes questioning inconsistent evidence and the reliability of documents and responses to inquiries. It also includes consideration of the sufficiency and appropriateness of evidence obtained in the light of the circumstances.

A79. Unless the engagement involves assurance about whether documents are genuine, the practitioner may accept records and documents as genuine unless the practitioner has reason to believe the contrary. Nevertheless, the practitioner is required by paragraph 50 to consider the reliability of information to be used as evidence.

A80. The practitioner cannot be expected to disregard past experience of the honesty and integrity of those who provide evidence. Nevertheless, a belief that those who provide evidence are honest and have integrity does not relieve the practitioner of the need to maintain professional skepticism.

Professional Judgment (Ref: Para. 38)

A81. Professional judgment is essential to the proper conduct of an assurance engagement. This is because interpretation of relevant ethical requirements and relevant HKSAEs and the informed decisions required throughout the engagement cannot be made without the application of relevant training, knowledge, and experience to the facts and circumstances. Professional judgment is necessary in particular regarding decisions about:

- Materiality and engagement risk.
- The nature, timing and extent of procedures used to meet the requirements of relevant HKSAEs and obtain evidence.
- Evaluating whether sufficient appropriate evidence has been obtained, and whether more needs to be done to achieve the objectives of this HKSAE and any relevant subject matter specific HKSAE. In particular, in the case of a limited assurance engagement, professional judgment is required in evaluating whether a meaningful level of assurance has been obtained.
- The appropriate conclusions to draw based on the evidence obtained.

A82. The distinguishing feature of the professional judgment expected of a practitioner is that it is exercised by a practitioner whose training, knowledge and experience have assisted in developing the necessary competencies to achieve reasonable judgments.

A83. The exercise of professional judgment in any particular case is based on the facts and circumstances that are known by the practitioner. Consultation on difficult or contentious matters during the course of the engagement, both within the engagement team and between the engagement team and others at the appropriate level within or outside the firm assist the practitioner in making informed and reasonable judgments, including the extent to which particular items in the subject matter information are affected by judgment of the appropriate party.

A84. Professional judgment can be evaluated based on whether the judgment reached reflects a competent application of assurance and measurement or evaluation principles and is appropriate in the light of, and consistent with, the facts and circumstances that were known to the practitioner up to the date of the practitioner's assurance report.

A85. Professional judgment needs to be exercised throughout the engagement. It also needs to be appropriately documented. In this regard, paragraph 79 requires the practitioner to prepare documentation sufficient to enable an experienced practitioner, having no previous connection with the engagement, to understand the significant professional judgments made in reaching conclusions on significant matters arising during the engagement. Professional judgment is not to be used as the justification for decisions that are not otherwise supported by the facts and circumstances of the engagement or sufficient appropriate evidence.

Planning and Performing the Engagement

Planning (Ref: Para. 40)

A86. Planning involves the engagement partner, other key members of the engagement team, and any key practitioner's external experts developing an overall strategy for the scope, emphasis, timing and conduct of the engagement, and an engagement plan, consisting of a detailed approach for the nature, timing and extent of procedures to be performed, and the reasons for selecting them. Adequate planning helps to devote appropriate attention to important areas of the engagement, identify potential problems on a timely basis and properly organize and manage the engagement in order for it to be performed in an effective and efficient manner. Adequate planning also assists the practitioner to properly assign work to engagement team members, and facilitates the direction, supervision, and the review of their work. Further, it assists, where applicable, the coordination of work done by other practitioners and experts. The nature and extent of planning activities will vary with the engagement circumstances, for example the complexity of the underlying subject matter and criteria. Examples of the main matters that may be considered include:

- The characteristics of the engagement that define its scope, including the terms of the engagement and the characteristics of the underlying subject matter and the criteria.
- The expected timing and the nature of the communications required.
- The results of engagement acceptance activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the appropriate party(ies) is relevant.
- The engagement process.
- The practitioner's understanding of the appropriate party(ies) and its environment, including the risks that the subject matter information may be materially misstated.
- Identification of intended users and their information needs, and consideration of materiality and the components of engagement risk.
- The extent to which the risk of fraud is relevant to the engagement.
- The nature, timing and extent of resources necessary to perform the engagement, such as personnel and expertise requirements, including the nature and extent of experts' involvement.
- The impact of the internal audit function on the engagement.

A87. The practitioner may decide to discuss elements of planning with the appropriate party(ies) to facilitate the conduct and management of the engagement (for example, to coordinate some of the planned procedures with the work of the appropriate party(ies)'s personnel). Although these discussions often occur, the overall engagement strategy and the engagement plan remain the practitioner's responsibility. When discussing matters included in the overall engagement strategy or engagement plan, care is required in order not to compromise the effectiveness of the engagement. For example, discussing the nature and timing of detailed procedures with the appropriate party(ies) may compromise the effectiveness of the engagement by making the procedures too predictable.

A88. Planning is not a discrete phase, but rather a continual and iterative process throughout the engagement. As a result of unexpected events, changes in conditions, or evidence obtained, the practitioner may need to revise the overall strategy and engagement plan, and thereby the resulting planned nature, timing and extent of procedures.

A89. In smaller or less complex engagements, the entire engagement may be conducted by a very small engagement team, possibly involving the engagement partner (who may be a sole practitioner) working without any other engagement team members. With a smaller team, co-ordination of, and communication between, team members is easier. Establishing the overall engagement strategy in such cases need not be a complex or time-consuming exercise; it varies according to the size of the entity, the complexity of the engagement, including the underlying subject matter and criteria, and the size of the engagement team. For example, in the case of a recurring engagement, a brief memorandum prepared at the completion of the previous period, based on a review of the working papers and highlighting issues identified in the engagement just completed, updated in the current period based on discussions with appropriate parties, can serve as the documented engagement strategy for the current engagement.

A90. If in the circumstances described in paragraph 43, the practitioner continues with the engagement:

(a) When, in the practitioner's professional judgment, the unsuitable applicable criteria or inappropriate underlying subject matter is likely to mislead the intended users, a qualified conclusion or adverse conclusion would be appropriate in the circumstances depending on how material and pervasive the matter is.

(b) In other cases, a qualified conclusion or a disclaimer of conclusion would be appropriate depending on, in the practitioner's professional judgment, how material and pervasive the matter is.

A91. For example, if after accepting the engagement, the practitioner discovers that the application of the applicable criteria leads to biased subject matter information, and the bias of the subject matter information is material and pervasive, then an adverse conclusion would be appropriate in the circumstances.

Materiality (Ref: Para. 44)

A92. Professional judgments about materiality are made in light of surrounding circumstances, but are not affected by the level of assurance, that is, for the same intended users and purpose, materiality for a reasonable assurance engagement is the same as for a limited assurance engagement because materiality is based on the information needs of intended users.

A93. The applicable criteria may discuss the concept of materiality in the context of the preparation and presentation of the subject matter information and thereby provide a frame of reference for the practitioner in considering materiality for the engagement. Although applicable criteria may discuss materiality in different terms, the concept of materiality generally includes the matters discussed in paragraphs A92–A100. If the applicable criteria do not include a discussion of the concept of materiality, these paragraphs provide the practitioner with a frame of reference.

A94. Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence relevant decisions of intended users taken on the basis of the subject matter information. The practitioner's consideration of materiality is a matter of professional judgment, and is affected by the practitioner's perception of the common information needs of intended users as a group. In this context, it is reasonable for the practitioner to assume that intended users:

(a) Have a reasonable knowledge of the underlying subject matter, and a willingness to study the subject matter information with reasonable diligence;

(b) Understand that the subject matter information is prepared and assured to appropriate levels of materiality, and have an understanding of any materiality concepts included in the applicable criteria;

(c) Understand any inherent uncertainties involved in the measuring or evaluating the underlying subject matter; and

(d) Make reasonable decisions on the basis of the subject matter information taken as a whole.

Unless the engagement has been designed to meet the particular information needs of specific users, the possible effect of misstatements on specific users, whose information needs may vary widely, is not ordinarily considered (see also paragraphs A16–A18).

A95. Materiality is considered in the context of qualitative factors and, when applicable, quantitative factors. The relative importance of qualitative factors and quantitative factors when considering materiality in a particular engagement is a matter for the practitioner's professional judgment.

A96. Qualitative factors may include such things as:

- The number of persons or entities affected by the subject matter.
- The interaction between, and relative importance of, various components of the subject matter information when it is made up of multiple components, such as a report that includes numerous performance indicators.
- The wording chosen with respect to subject matter information that is expressed in narrative form.
- The characteristics of the presentation adopted for the subject matter information when the applicable criteria allow for variations in that presentation.
- The nature of a misstatement, for example, the nature of observed deviations from a control when the subject matter information is a statement that the control is effective.
- Whether a misstatement affects compliance with law or regulation.
- In the case of periodic reporting on an underlying subject matter, the effect of an adjustment that affects past or current subject matter information or is likely to affect future subject matter information.
- Whether a misstatement is the result of an intentional act or is unintentional.
- Whether a misstatement is significant having regard to the practitioner's understanding of known previous communications to users, for example, in relation to the expected outcome of the measurement or evaluation of the underlying subject matter.
- Whether a misstatement relates to the relationship between the responsible party, the measurer or evaluator, or the engaging party or their relationship with other parties.
- When a threshold or benchmark value has been identified, whether the result of the procedure deviates from that value.
- When the underlying subject matter is a governmental program or public sector entity, whether a particular aspect of the program or entity is significant with regard to the nature, visibility and sensitivity of the program or entity.
- When the subject matter information relates to a conclusion on compliance with law or regulation, the seriousness of the consequences of non-compliance.

A97. Quantitative factors relate to the magnitude of misstatements relative to reported amounts for those aspects of the subject matter information, if any, that are:

- Expressed numerically; or

- Otherwise related to numerical values (for example, the number of observed deviations from a control may be a relevant quantitative factor when the subject matter information is a statement that the control is effective).

A98. When quantitative factors are applicable, planning the engagement solely to detect individually material misstatements overlooks the fact that the aggregate of uncorrected and undetected individually immaterial misstatements may cause the subject matter information to be materially misstated. It may therefore be appropriate when planning the nature, timing and extent of procedures for the practitioner to determine a quantity less than materiality as a basis for determining the nature, timing and extent of procedures.

A99. Materiality relates to the information covered by the assurance report. Therefore, when the engagement covers some, but not all, aspects of the information communicated about an underlying subject matter, materiality is considered in relation to only that portion that is covered by the engagement.

A100. Concluding on the materiality of the misstatements identified as a result of the procedures performed requires professional judgment. For example:

- The applicable criteria for a value for money engagement for a hospital's emergency department may include the speed of the services provided, the quality of the services, the number of patients treated during a shift, and benchmarking the cost of the services against other similar hospitals. If three of these applicable criteria are satisfied but one applicable criterion is not satisfied by a small margin, then professional judgment is needed to conclude whether the hospital's emergency department represents value for money as a whole.

- In a compliance engagement, the entity may have complied with nine provisions of the relevant law or regulation, but did not comply with one provision. Professional judgment is needed to conclude whether the entity complied with the relevant law or regulation as a whole. For example, the practitioner may consider the significance of the provision with which the entity did not comply, as well as the relationship of that provision to the remaining provisions of the relevant law or regulation.

Understanding the Engagement Circumstances (Ref: Para. 45–47R)

A101. Discussions between the engagement partner and other key members of the engagement team, and any key practitioner's external experts, about the susceptibility of the subject matter information to material misstatement, and the application of the applicable criteria to the facts and circumstances of the engagement, may assist the engagement team in planning and performing the engagement. It is also useful to communicate relevant matters to members of the engagement team, and to any practitioner's external experts not involved in the discussion.

A102. The practitioner may have additional responsibilities under law, regulation or relevant ethical requirements regarding an entity's non-compliance with laws and regulations, which may differ from or go beyond the practitioner's responsibilities under this HKSAE, such as:

(a) Responding to identified or suspected non-compliance with laws and regulations, including requirements in relation to specific communications with management and those charged with governance and considering whether further action is needed;

(b) Communicating identified or suspected non-compliance with laws and regulations to an auditor;[7] and

(c) Documentation requirements regarding identified or suspected non-compliance with laws and regulations.

[7] See, for example, Sections 225.44–225.48 of the Code.

Complying with any additional responsibilities may provide further information that is relevant to the practitioner's work in accordance with this and any other HKSAE (e.g., regarding the integrity of the responsible party or those charged with governance). Paragraphs A194–A198 further address the practitioner's responsibilities under law, regulation or relevant ethical requirements regarding communicating and reporting identified or suspected non-compliance with laws and regulations.

A103. Obtaining an understanding of the underlying subject matter and other engagement circumstances provides the practitioner with a frame of reference for exercising professional judgment throughout the engagement, for example when:

- Considering the characteristics of the underlying subject matter;
- Assessing the suitability of criteria;
- Considering the factors that, in the practitioner's professional judgment, are significant in directing the engagement team's efforts, including where special consideration may be necessary; for example, the need for specialized skills or the work of an expert;
- Establishing and evaluating the continued appropriateness of quantitative materiality levels (where appropriate), and considering qualitative materiality factors;
- Developing expectations for use when performing analytical procedures;
- Designing and performing procedures; and
- Evaluating evidence, including the reasonableness of the oral and written representations received by the practitioner.

A104. The practitioner ordinarily has a lesser depth of understanding of the underlying subject matter and other engagement circumstances than the responsible party. The practitioner also ordinarily has a lesser depth of understanding of the underlying subject matter and other engagement circumstances for a limited assurance engagement than for a reasonable assurance engagement, for example, while in some limited assurance engagements the practitioner may obtain an understanding of internal control over the preparation of the subject matter information, this is often not the case.

A105. In a limited assurance engagement, identifying the areas where a material misstatement of the subject matter information is likely to arise enables the practitioner to focus procedures on those areas. For example, in an engagement when the subject matter information is a sustainability report, the practitioner may focus on certain areas of the sustainability report. The practitioner may design and perform procedures over the entire subject matter information when the subject matter information consists of only a single area or when obtaining assurance over all areas of the subject matter information is necessary to obtain meaningful assurance.

A106. In a reasonable assurance engagement, understanding internal control over the subject matter information assists the practitioner in identifying the types of misstatements and factors that affect the risks of material misstatements in the subject matter information. The practitioner is required to evaluate the design of relevant controls and determines whether they have been implemented, by performing procedures in addition to inquiry of the responsible party. Professional judgment is needed to determine which controls are relevant in the engagement circumstances.

A107. In a limited assurance engagement, considering the process used to prepare the subject matter information assists the practitioner in designing and performing procedures that address the areas where a material misstatement of the subject matter information is likely to arise. In considering the process used, the practitioner uses professional judgment to determine which aspects of the process are relevant to the engagement, and may make inquiries of the appropriate party about those aspects.

A108. In both a reasonable assurance and a limited assurance engagement, the results of the entity's risk assessment process may also assist the practitioner in obtaining an understanding of the underlying subject matter and other engagement circumstances.

Obtaining Evidence

The Nature, Timing and Extent of Procedures (Ref: Para. 48(L)–49(R))

A109. The practitioner chooses a combination of procedures to obtain reasonable assurance or limited assurance, as appropriate. The procedures listed below may be used, for example, for planning or performing the engagement, depending on the context in which they are applied by the practitioner:

- Inspection;
- Observation;
- Confirmation;
- Recalculation;
- Reperformance;
- Analytical procedures; and
- Inquiry.

A110. Factors that may affect the practitioner's selection of procedures include the nature of the underlying subject matter; the level of assurance to be obtained; and the information needs of the intended users and the engaging party, including relevant time and cost constraints.

A111. In some cases, a subject matter-specific HKSAE may include requirements that affect the nature, timing and extent of procedures. For example, a subject matter-specific HKSAE may describe the nature or extent of particular procedures to be performed or the level of assurance expected to be obtained in a particular type of engagement. Even in such cases, determining the exact nature, timing and extent of procedures is a matter of professional judgment and will vary from one engagement to the next.

A112. In some engagements, the practitioner may not identify any areas where a material misstatement of the subject matter information is likely to arise. Irrespective of whether any such areas have been identified, the practitioner designs and performs procedures to obtain a meaningful level of assurance.

A113. An assurance engagement is an iterative process, and information may come to the practitioner's attention that differs significantly from that on which the determination of planned procedures was based. As the practitioner performs planned procedures, the evidence obtained may cause the practitioner to perform additional procedures. Such procedures may include asking the measurer or evaluator to examine the matter identified by the practitioner, and to make adjustments to the subject matter information if appropriate.

Determining Whether Additional Procedures Are Necessary in a Limited Assurance Engagement (Ref: Para. 49L)

A114. The practitioner may become aware of misstatements that are, after applying professional judgment, clearly not indicative of the existence of material misstatements. The following examples illustrate when additional procedures may not be needed because, in the practitioner's professional judgment, the identified misstatements are clearly not indicative of the existence of material misstatements:

- If materiality is 10,000 units, and the practitioner judges that a potential error of 100 units may exist, then additional procedures would not generally be required, unless there are other qualitative factors that need to be considered, because the risk of a material misstatement is likely to be acceptable in the engagement circumstances.

- If, in performing a set of procedures over an area where material misstatements are likely, a response to one inquiry among many was not as expected, additional procedures may not be needed if the risk of a material misstatement is, nevertheless, at a level that is acceptable in the circumstances of the engagement in light of the results of other procedures.

A115. The practitioner may become aware of a matter(s) that causes the practitioner to believe that the subject matter information may be materially misstated. The following examples illustrate when additional procedures may be needed as the identified misstatements indicate that the subject matter information may be materially misstated:

- When performing analytical procedures, the practitioner may identify a fluctuation or relationship that is inconsistent with other relevant information or that differs significantly from expected amounts or ratios.

- The practitioner may become aware of a potential material misstatement from reviewing external sources.

- If the applicable criteria permit a 10% error rate and, based on a particular test, the practitioner discovered a 9% error rate, then additional procedures may be needed because the risk of a material misstatement may not be acceptable in the engagement circumstances.

- If the results of analytical procedures are within expectations but are, nevertheless, close to exceeding the expected value, then additional procedures may be needed because the risk of a material misstatement may not be acceptable in the engagement circumstances.

A116. If, in the case of a limited assurance engagement, a matter(s) comes to the practitioner's attention that causes the practitioner to believe the subject matter information may be materially misstated, the practitioner is required by paragraph 49L to design and perform additional procedures. Additional procedures may include, for example, inquiring of the appropriate party(ies) or performing other procedures as appropriate in the circumstances.

A117. If, having performed the additional procedures required by paragraph 49L, the practitioner is not able to obtain sufficient appropriate evidence to either conclude that the matter(s) is not likely to cause the subject matter information to be materially misstated or determine that it does cause the subject matter information to be materially misstated, a scope limitation exists and paragraph 66 applies.

A118. The practitioner's judgment about the nature, timing and extent of additional procedures that are needed to obtain evidence to either conclude that a material misstatement is not likely, or determine that a material misstatement exists, is, for example, guided by:

- Information obtained from the practitioner's evaluation of the results of the procedures already performed;

- The practitioner's updated understanding of the underlying subject matter and other engagement circumstances obtained throughout the course of the engagement; and

- The practitioner's view on the persuasiveness of evidence needed to address the matter that causes the practitioner to believe that the subject matter information may be materially misstated.

Accumulating Uncorrected Misstatements (Ref: Para. 51, 65)

A119. Uncorrected misstatements are accumulated during the engagement (see paragraph 51) for the purpose of evaluating whether, individually or in aggregate, they are material when forming the practitioner's conclusion.

A120. The practitioner may designate an amount below which misstatements would be clearly trivial and would not need to be accumulated because the practitioner expects that the accumulation of such amounts clearly would not have a material effect on the subject matter information. "Clearly trivial" is not another expression for "not material." Matters that are clearly trivial will be of a wholly different (smaller) order of magnitude than materiality determined in accordance with paragraph 44, and will be matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any criteria of size, nature or circumstances. When there is any uncertainty about whether one or more items are clearly trivial, the matter is considered not to be clearly trivial.

Considerations When a Practitioner's Expert Is Involved on the Engagement

Nature, Timing and Extent of Procedures (Ref: Para. 52)

A121. The following matters are often relevant when determining the nature, timing and extent of procedures with respect to the work of a practitioner's expert when some of the assurance work is performed by one or more practitioner's expert (see paragraph A70):

(a) The significance of that expert's work in the context of the engagement (see also paragraphs A122–A123);

(b) The nature of the matter to which that expert's work relates;

(c) The risks of material misstatement in the matter to which that expert's work relates;

(d) The practitioner's knowledge of and experience with previous work performed by that expert; and

(e) Whether that expert is subject to the practitioner's firm's quality control policies and procedures (see also paragraphs A124–A125).

Integrating the work of a practitioner's expert

A122. Assurance engagements may be performed on a wide range of underlying subject matters that require specialized skills and knowledge beyond those possessed by the engagement partner and other members of the engagement team and for which the work of a practitioner's expert is used. In some situations, the practitioner's expert will be consulted to provide advice on an individual matter, but the greater the significance of the practitioner's expert's work in the context of the engagement, the more likely it is that expert will work as part of a multi-disciplinary team comprising subject matter experts and other assurance personnel. The more that expert's work is integrated in nature, timing and extent with the overall work effort, the more important effective two-way communication is between the practitioner's expert and other assurance personnel. Effective two-way communication facilitates the proper integration of the expert's work with the work of others on the engagement.

A123. As noted in paragraph A71, when the work of a practitioner's expert is to be used, it may be appropriate to perform some of the procedures required by paragraph 52 at the engagement acceptance or continuance stage. This is particularly so when the work of the practitioner's expert will be fully integrated with the work of other assurance personnel and when the work of the practitioner's expert is to be used in the early stages of the engagement, for example during initial planning and risk assessment.

The practitioner's firm's quality control policies and procedures

A124. A practitioner's internal expert may be a partner or staff, including temporary staff, of the practitioner's firm, and therefore subject to the quality control policies and procedures of that firm in accordance with HKSQC 1 or other professional requirements, or requirements in law or regulation, that are at least as demanding as HKSQC 1. Alternatively, a practitioner's internal expert may be a partner or staff, including temporary staff, of a network firm, which may share common quality control policies and procedures with the practitioner's firm. A practitioner's external expert is not a member of the engagement team and is not subject to quality control policies and procedures in accordance with HKSQC 1.

A125. Engagement teams are entitled to rely on the firm's system of quality control, unless information provided by the firm or other parties suggests otherwise. The extent of that reliance will vary with the circumstances, and may affect the nature, timing and extent of the practitioner's procedures with respect to such matters as:

- Competence and capabilities, through recruitment and training programs.
- The practitioner's evaluation of the objectivity of the practitioner's expert. Practitioner's internal experts are subject to relevant ethical requirements, including those pertaining to independence.
- The practitioner's evaluation of the adequacy of the practitioner's expert's work. For example, the firm's training programs may provide the practitioner's internal experts with an appropriate understanding of the interrelationship of their expertise with the evidence gathering process. Reliance on such training and other firm processes, such as protocols for scoping the work of the practitioner's internal experts, may affect the nature, timing and extent of the practitioner's procedures to evaluate the adequacy of the practitioner's expert's work.
- Adherence to regulatory and legal requirements, through monitoring processes.
- Agreement with the practitioner's expert.

Such reliance does not reduce the practitioner's responsibility to meet the requirements of this HKSAE.

The Competence, Capabilities and Objectivity of the Practitioner's Expert (Ref: Para. 52(a))

A126. Information regarding the competence, capabilities and objectivity of a practitioner's expert may come from a variety of sources, such as:

- Personal experience with previous work of that expert.
- Discussions with that expert.
- Discussions with other practitioners or others who are familiar with that expert's work.
- Knowledge of that expert's qualifications, membership of a professional body or industry association, license to practice, or other forms of external recognition.
- Published papers or books written by that expert.
- The firm's quality control policies and procedures (see also paragraphs A124–A125).

A127. While practitioner's experts do not require the same proficiency as the practitioner in performing all aspects of an assurance engagement, a practitioner's expert whose work is used may need a sufficient understanding of relevant HKSAEs to enable that expert to relate the work assigned to them to the engagement objective.

A128. The evaluation of the significance of threats to objectivity and of whether there is a need for safeguards may depend upon the role of the practitioner's expert and the significance of the expert's work in the context of the engagement. There may be some circumstances in which safeguards cannot reduce threats to an acceptable level, for example, if a proposed practitioner's expert is an individual who has played a significant role in preparing the subject matter information.

A129. When evaluating the objectivity of a practitioner's external expert, it may be relevant to:

- Inquire of the appropriate party(ies) about any known interests or relationships that the appropriate party(ies) has with the practitioner's external expert that may affect that expert's objectivity.
- Discuss with that expert any applicable safeguards, including any professional requirements that apply to that expert, and evaluate whether the safeguards are adequate to reduce threats to an acceptable level. Interests and relationships that it may be relevant to discuss with the practitioner's expert include:
  - Financial interests.
  - Business and personal relationships.
  - Provision of other services by the expert, including by the organization in the case of an external expert that is an organization.

  In some cases, it may also be appropriate for the practitioner to obtain a written representation from the practitioner's external expert about any interests or relationships with the appropriate party(ies) of which that expert is aware.

Obtaining an Understanding of the Field of Expertise of the Practitioner's Expert (Ref: Para. 52(b))

A130. Having a sufficient understanding of the field of expertise of the practitioner's expert enables the practitioner to:

(a) Agree with the practitioner's expert the nature, scope and objectives of that expert's work for the practitioner's purposes; and

(b) Evaluate the adequacy of that work for the practitioner's purposes.

A131. Aspects of the practitioner's expert's field relevant to the practitioner's understanding may include:

- Whether that expert's field has areas of specialty within it that are relevant to the engagement.
- Whether any professional or other standards and regulatory or legal requirements apply.
- What assumptions and methods, including models where applicable, are used by the practitioner's expert, and whether they are generally accepted within that expert's field and appropriate in the circumstances of the engagement.
- The nature of internal and external data or information the practitioner's expert uses.

Agreement with the Practitioner's Expert (Ref: Para. 52(c))

A132. It may be appropriate for the practitioner's agreement with the practitioner's expert to also include matters such as the following:

(a) The respective roles and responsibilities of the practitioner and that expert;

(b) The nature, timing and extent of communication between the practitioner and that expert, including the form of any report to be provided by that expert; and

(c) The need for the practitioner's expert to observe confidentiality requirements.

A133. The matters noted in paragraph A125 may affect the level of detail and formality of the agreement between the practitioner and the practitioner's expert, including whether it is appropriate that the agreement be in writing. The agreement between the practitioner and a practitioner's external expert is often in the form of an engagement letter.

Evaluating the Adequacy of the Practitioner's Expert's Work (Ref: Para. 52(d))

A134. The following matters may be relevant when evaluating the adequacy of the practitioner's expert's work for the practitioner's purposes:

(a) The relevance and reasonableness of that expert's findings or conclusions, and their consistency with other evidence;

(b) If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods in the circumstances; and

(c) If that expert's work involves the use of source data that is significant to that expert's work, the relevance, completeness, and accuracy of that source data.

A135. If the practitioner determines that the work of the practitioner's expert is not adequate for the practitioner's purposes, options available to the practitioner include:

(a) Agreeing with that expert on the nature and extent of further work to be performed by that expert; or

(b) Performing additional procedures appropriate to the circumstances.

Work Performed by Another Practitioner, a Responsible Party's or Measurer's or Evaluator's Expert or an Internal Auditor (Ref: Para. 53–55)

A136. While paragraphs A121–A135 have been written in the context of using work performed by a practitioner's expert, they may also provide helpful guidance with respect to using work performed by another practitioner, a responsible party's or measurer's or evaluator's expert, or an internal auditor.

Written Representations (Ref: Para. 56)

A137. Written confirmation of oral representations reduces the possibility of misunderstandings between the practitioner and the appropriate party(ies). The person(s) from whom the practitioner requests written representations will ordinarily be a member of senior management or those charged with governance depending on, for example, the management and governance structure of the appropriate party(ies), which may vary by jurisdiction and by entity, reflecting influences such as different cultural and legal backgrounds, and size and ownership characteristics.

A138. Other written representations requested may include the following:

- Whether the appropriate party(ies) believes the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the subject matter information. A summary of such items is ordinarily included in or attached to the written representation;

- That significant assumptions used in making any material estimates are reasonable;

- That the appropriate party(ies) has communicated to the practitioner all deficiencies in internal control relevant to the engagement that are not clearly trivial and inconsequential of which the appropriate party(ies) is aware; and

- When the responsible party is different from the measurer or evaluator, that the responsible party acknowledges responsibility for the underlying subject matter.

A139. Representations by the appropriate party(ies) cannot replace other evidence the practitioner could reasonably expect to be available. Although written representations provide necessary evidence, they do not provide sufficient appropriate evidence on their own about any of the matters with which they deal. Furthermore, the fact that the practitioner has received reliable written representations does not affect the nature or extent of other evidence that the practitioner obtains.

Requested Written Representations Not Provided or Not Reliable (Ref: Para. 60)

A140. Circumstances in which the practitioner may not be able to obtain requested written representations include, for example, when:

- The responsible party contracts a third party to perform the relevant measurement or evaluation and later engages the practitioner to undertake an assurance engagement on the resultant subject matter information. In some such cases, for example where the responsible party has an ongoing relationship with the measurer or evaluator, the responsible party may be able to arrange for the measurer or evaluator to provide requested written representations, or the responsible party may be in a position to provide such representations if the responsible party has a reasonable basis for doing so, but, in other cases, this may not be so.

- An intended user engages the practitioner to undertake an assurance engagement on publicly available information but does not have a relationship with the responsible party of the kind necessary to ensure that party responds to the practitioner's request for a written representation.

- The assurance engagement is undertaken against the wishes of the measurer or evaluator. This may be the case when, for example, the engagement is undertaken pursuant to a court order, or a public sector practitioner is required by the legislature or other competent authority to undertake a particular engagement.

In these or similar circumstances, the practitioner may not have access to the evidence needed to support the practitioner's conclusion. If this is the case, paragraph 66 of this HKSAE applies.

Subsequent Events (Ref: Para. 61)

A141. Consideration of subsequent events in some assurance engagements may not be relevant because of the nature of the underlying subject matter. For example, when the engagement requires a conclusion about the accuracy of a statistical return at a point in time, events occurring between that point in time and the date of the assurance report may not affect the conclusion or require disclosure in the return or the assurance report.

A142. As noted in paragraph 61, the practitioner has no responsibility to perform any procedures regarding the subject matter information after the date of the practitioner's report. However, if, after the date of the practitioner's report, a fact becomes known to the practitioner that, had it been known to the practitioner at the date of the practitioner's report, may have caused the practitioner to amend the report, the practitioner may need to discuss the matter with the appropriate party(ies) or take other action as appropriate in the circumstances.

Other Information (Ref: Para. 62)

A143. Further actions that may be appropriate if the practitioner identifies a material inconsistency or becomes aware of a material misstatement of fact include, for example:

- Requesting the appropriate party(ies) to consult with a qualified third party, such as the appropriate party(ies)'s legal counsel.
- Obtaining legal advice about the consequences of different courses of action.
- Communicating with third parties (for example, a regulator).
- Withholding the assurance report.
- Withdrawing from the engagement, where withdrawal is possible under applicable law or regulation.
- Describing the material inconsistency in the assurance report.

Description of Applicable Criteria (Ref: Para. 63)

A144. The description of the applicable criteria advises intended users of the framework on which the subject matter information is based, and is particularly important when there are significant differences between various criteria regarding how particular matters may be treated in the subject matter information.

A145. A description that the subject matter information is prepared in accordance with particular applicable criteria is appropriate only if the subject matter information complies with all relevant requirements of those applicable criteria that are effective.

A146. A description of the applicable criteria that contains imprecise qualifying or limiting language (for example, "the subject matter information is in substantial compliance with the requirements of XYZ") is not an adequate description as it may mislead users of the subject matter information.

Forming the Assurance Conclusion

Sufficiency and Appropriateness of Evidence (Ref: Para. 12(i), 64)

A147. Evidence is necessary to support the practitioner's conclusion and assurance report. It is cumulative in nature and is primarily obtained from procedures performed during the course of the engagement. It may, however, also include information obtained from other sources such as previous engagements (provided the practitioner has determined whether changes have occurred since the previous engagement that may affect its relevance to the current engagement) or a firm's quality control procedures for client acceptance and continuance. Evidence may come from sources inside and outside the appropriate party(ies). Also, information that may be used as evidence may have been prepared by an expert employed or engaged by the appropriate party(ies). Evidence comprises both information that supports and corroborates aspects of the subject matter information, and any information that contradicts aspects of the subject matter information. In addition, in some cases, the absence of information (for example, refusal by the appropriate party(ies) to provide a requested representation) is used by the practitioner, and therefore, also constitutes evidence. Most of the practitioner's work in forming the assurance conclusion consists of obtaining and evaluating evidence.

A148. The sufficiency and appropriateness of evidence are interrelated. Sufficiency is the measure of the quantity of evidence. The quantity of evidence needed is affected by the risks of the subject matter information being materially misstated (the higher the risks, the more evidence is likely to be required) and also by the quality of such evidence (the higher the quality, the less may be required). Obtaining more evidence, however, may not compensate for its poor quality.

A149. Appropriateness is the measure of the quality of evidence; that is, its relevance and its reliability in providing support for the practitioner's conclusion. The reliability of evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained. Generalizations about the reliability of various kinds of evidence can be made; however, such generalizations are subject to important exceptions. Even when evidence is obtained from sources external to the appropriate party(ies), circumstances may exist that could affect its reliability. For example, evidence obtained from an external source may not be reliable if the source is not knowledgeable or objective. While recognizing that exceptions may exist, the following generalizations about the reliability of evidence may be useful:

- Evidence is more reliable when it is obtained from sources outside the appropriate party(ies).
- Evidence that is generated internally is more reliable when the related controls are effective.
- Evidence obtained directly by the practitioner (for example, observation of the application of a control) is more reliable than evidence obtained indirectly or by inference (for example, inquiry about the application of a control).
- Evidence is more reliable when it exists in documentary form, whether paper, electronic, or other media (for example, a contemporaneously written record of a meeting is ordinarily more reliable than a subsequent oral representation of what was discussed).

A150. The practitioner ordinarily obtains more assurance from consistent evidence obtained from different sources or of a different nature than from items of evidence considered individually. In addition, obtaining evidence from different sources or of a different nature may indicate that an individual item of evidence is not reliable. For example, corroborating information obtained from a source independent of the appropriate party(ies) may increase the assurance the practitioner obtains from a representation from the appropriate party(ies). Conversely, when evidence obtained from one source is inconsistent with that obtained from another, the practitioner determines what additional procedures are necessary to resolve the inconsistency.

A151. In terms of obtaining sufficient appropriate evidence, it is generally more difficult to obtain assurance about subject matter information covering a period than about subject matter information at a point in time. In addition, conclusions provided on processes ordinarily are limited to the period covered by the engagement; the practitioner provides no conclusion about whether the process will continue to function in the specified manner in the future.

A152. Whether sufficient appropriate evidence has been obtained on which to base the practitioner's conclusion is a matter of professional judgment.

A153. In some circumstances, the practitioner may not have obtained the sufficiency or appropriateness of evidence that the practitioner had expected to obtain through the planned procedures. In these circumstances, the practitioner considers that the evidence obtained from the procedures performed is not sufficient and appropriate to be able to form a conclusion on the subject matter information. The practitioner may:

- Extend the work performed; or
- Perform other procedures judged by the practitioner to be necessary in the circumstances.

Where neither of these is practicable in the circumstances, the practitioner will not be able to obtain sufficient appropriate evidence to be able to form a conclusion. This situation may arise even though the practitioner has not become aware of a matter(s) that causes the practitioner to believe the subject matter information may be materially misstated, as addressed in paragraph 49L.

Evaluating the Sufficiency and Appropriateness of Evidence (Ref: Para. 65)

A154. An assurance engagement is a cumulative and iterative process. As the practitioner performs planned procedures, the evidence obtained may cause the practitioner to change the nature, timing or extent of other planned procedures. Information may come to the practitioner's attention that differs significantly from that expected and upon which planned procedures were based. For example:

- The extent of misstatements that the practitioner identifies may alter the practitioner's professional judgment about the reliability of particular sources of information.

- The practitioner may become aware of discrepancies in relevant information, or inconsistent or missing evidence.

- If analytical procedures were performed towards the end of the engagement, the results of those procedures may indicate a previously unrecognized risk of material misstatement.

In such circumstances, the practitioner may need to reevaluate the planned procedures.

A155. The practitioner's professional judgment as to what constitutes sufficient appropriate evidence is influenced by such factors as the following:

- Significance of a potential misstatement and the likelihood of its having a material effect, individually or when aggregated with other potential misstatements, on the subject matter information.

- Effectiveness of the appropriate party(ies)'s responses to address the known risk of material misstatement.

- Experience gained during previous assurance engagements with respect to similar potential misstatements.

- Results of procedures performed, including whether such procedures identified specific misstatements.

- Source and reliability of the available information.

- Persuasiveness of the evidence.

- Understanding of the appropriate party(ies) and its environment.

Scope Limitations (Ref: Para. 26, 66)

A156. A scope limitation may arise from:

(a) Circumstances beyond the control of the appropriate party(ies). For example, documentation the practitioner considers it necessary to inspect may have been accidentally destroyed;

(b) Circumstances relating to the nature or timing of the practitioner's work. For example, a physical process the practitioner considers it necessary to observe may have occurred before the practitioner's engagement; or

(c) Limitations imposed by the responsible party, the measurer or evaluator, or the engaging party on the practitioner that, for example, may prevent the practitioner from performing a procedure the practitioner considers to be necessary in the circumstances. Limitations of this kind may have other implications for the engagement, such as for the practitioner's consideration of engagement risk and engagement acceptance and continuance.

A157. An inability to perform a specific procedure does not constitute a scope limitation if the practitioner is able to obtain sufficient appropriate evidence by performing alternative procedures.

A158. The procedures performed in a limited assurance engagement are, by definition, limited compared with that necessary in a reasonable assurance engagement. Limitations known to exist prior to accepting a limited assurance engagement are a relevant consideration when establishing whether the preconditions for an assurance engagement are present, in particular, whether the engagement exhibits the characteristics of access to evidence (see paragraph 24b)(iv)) and a rational purpose (see paragraph 24(b)(vi)). If a further limitation is imposed by the appropriate party(ies) after a limited assurance engagement has been accepted, it may be appropriate to withdraw from the engagement, where withdrawal is possible under applicable law or regulation.

Preparing the Assurance Report

Form of Assurance Report (Ref: Para. 67–68)

A159. Oral and other forms of expressing conclusions can be misunderstood without the support of a written report. For this reason, the practitioner does not report orally or by use of symbols without also providing a written assurance report that is readily available whenever the oral report is provided or the symbol is used. For example, a symbol could be hyperlinked to a written assurance report on the Internet.

A160. This HKSAE does not require a standardized format for reporting on all assurance engagements. Instead it identifies the basic elements the assurance report is to include. Assurance reports are tailored to the specific engagement circumstances. The practitioner may use headings, paragraph numbers, typographical devices, for example the bolding of text, and other mechanisms to enhance the clarity and readability of the assurance report.

A161. The practitioner may choose a "short-form" or "long-form" style of reporting to facilitate effective communication to the intended users. "Short-form" reports ordinarily include only the basic elements. "Long-form" reports include other information and explanations that are not intended to affect the practitioner's conclusion. In addition to the basic elements, long-form reports may describe in detail the terms of the engagement, the applicable criteria being used, findings relating to particular aspects of the engagement, details of the qualifications and experience of the practitioner and others involved with the engagement, disclosure of materiality levels, and, in some cases, recommendations. The practitioner may find it helpful to consider the significance of providing such information to the information needs of the intended users. As required by paragraph 68, additional information is clearly separated from the practitioner's conclusion and phrased in such a manner so as make it clear that it is not intended to detract from that conclusion.

Assurance Report Content

Title (Ref: Para. 69(a))

A162. An appropriate title helps to identify the nature of the assurance report, and to distinguish it from reports issued by others, such as those who do not have to comply with the same ethical requirements as the practitioner.

Addressee (Ref: Para. 69(b))

A163. An addressee identifies the party or parties to whom the assurance report is directed. The assurance report is ordinarily addressed to the engaging party, but, in some cases, there may be other intended users.

Subject Matter Information and Underlying Subject Matter (Ref: Para. 69(c))

A164. Identification and description of the subject matter information and, when appropriate, the underlying subject matter may include, for example:

- The point in time or period of time to which the measurement or evaluation of the underlying subject matter relates.
- Where applicable, the name of the responsible party or component of the responsible party to which the underlying subject matter relates.

- An explanation of those characteristics of the underlying subject matter or the subject matter information of which the intended users should be aware, and how such characteristics may influence the precision of the measurement or evaluation of the underlying subject matter against the applicable criteria, or the persuasiveness of available evidence. For example:
    - The degree to which the subject matter information is qualitative versus quantitative, objective versus subjective, or historical versus prospective.
    - Changes in the underlying subject matter or other engagement circumstances that affect the comparability of the subject matter information from one period to the next.

Applicable Criteria (Ref: Para. 69(d))

A165. The assurance report identifies the applicable criteria against which the underlying subject matter was measured or evaluated so the intended users can understand the basis for the practitioner's conclusion. The assurance report may include the applicable criteria, or refer to them if they are included in the subject matter information or if they are otherwise available from a readily accessible source. It may be relevant in the circumstances, to disclose:

- The source of the applicable criteria, and whether or not the applicable criteria are embodied in law or regulation, or issued by authorized or recognized bodies of experts that follow a transparent due process, that is, whether they are established criteria in the context of the underlying subject matter (and if they are not, a description of why they are considered suitable).
- Measurement or evaluation methods used when the applicable criteria allow for choice between a number of methods.
- Any significant interpretations made in applying the applicable criteria in the engagement circumstances.
- Whether there have been any changes in the measurement or evaluation methods used.

Inherent Limitations (Ref: Para. 69(e))

A166. While in some cases, inherent limitations can be expected to be well-understood by the intended users of an assurance report, in other cases it may be appropriate to make explicit reference to them in the assurance report. For example, in an assurance report related to the effectiveness of internal control, it may be appropriate to note that the historic evaluation of effectiveness is not relevant to future periods due to the risk that internal control may become inadequate because of changes in conditions, or that the degree of compliance with policies or procedures may deteriorate.

Specific Purpose (Ref: Para. 69(f))

A167. In some cases, the applicable criteria used to measure or evaluate the underlying subject matter may be designed for a specific purpose. For example, a regulator may require certain entities to use particular applicable criteria designed for regulatory purposes. To avoid misunderstandings, the practitioner alerts readers of the assurance report to this fact and that, therefore, the subject matter information may not be suitable for another purpose.

A168. In addition to the alert required by paragraph 69(f), the practitioner may consider it appropriate to indicate that the assurance report is intended solely for specific users. Depending on the engagement circumstances, for example, the law or regulation of the particular jurisdiction, this may be achieved by restricting the distribution or use of the assurance report. While an assurance report may be restricted in this way, the absence of a restriction regarding a particular user or purpose does not itself indicate that a legal responsibility is owed by the practitioner in relation to that user or for that purpose. Whether a legal responsibility is owed will depend on the legal circumstances of each case and the relevant jurisdiction.

Relative Responsibilities (Ref: Para. 69(g))

A169. Identifying relative responsibilities informs the intended users that the responsible party is responsible for the underlying subject matter, that the measurer or evaluator is responsible for the measurement or evaluation of the underlying subject matter against the applicable criteria, and that the practitioner's role is to independently express a conclusion about the subject matter information.

Performance of the Engagement in Accordance with HKSAE 3000 (Revised) and a Subject Matter Specific HKSAE (Ref: Para. 69(h))

A170. Where a subject matter specific HKSAE applies to only part of the subject matter information, it may be appropriate to cite both that subject matter specific HKSAE and this HKSAE.

A171. A statement that contains imprecise qualifying or limiting language (for example "the engagement was performed by reference to HKSAE 3000") may mislead users of assurance reports.

Applicable Quality Control Requirements (Ref: Para. 69(i))

A172. The following is an illustration of a statement in the assurance report regarding applicable quality control requirements:

> The firm applies Hong Kong Standard on Quality Control 1 and, accordingly, maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

Compliance with Independence and Other Ethical Requirements (Ref: Para. 69(j))

A173. The following is an illustration of a statement in the assurance report regarding compliance with ethical requirements:

> We have complied with the independence and other ethical requirements of the *Code of Ethics for Professional Accountants* issued by the Hong Kong Institute of Certified Public Accountants, which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

Summary of the Work Performed (Ref: Para. A6, 69(k))

A174. The summary of the work performed helps the intended users understand the practitioner's conclusion. For many assurance engagements, infinite variations in procedures are possible in theory. In practice, however, these are difficult to communicate clearly and unambiguously. Other authoritative pronouncements issued by the Hong Kong Institute of Certified Public Accountants may be useful to practitioners in preparing the summary.

A175. Where no specific HKSAE provides guidance on procedures for a particular underlying subject matter, the summary might include a more detailed description of the work performed. It may be appropriate to include in the summary a statement that the work performed included evaluating the suitability of the applicable criteria.

A176. In a limited assurance engagement the summary of the work performed is ordinarily more detailed than for a reasonable assurance engagement and identifies the limitations on the nature, timing and extent of procedures. This is because an appreciation of the nature, timing and extent of procedures performed is essential to understanding a conclusion expressed in a form that conveys whether, based on the procedures performed, a material matter(s) has come to the practitioner's attention to cause the practitioner to believe the subject matter information is materially misstated. It also may be appropriate to indicate in the summary of the work performed certain procedures that were not performed that would ordinarily be expected to be performed in a reasonable assurance engagement. However, a complete identification of all such procedures may not be possible because the practitioner's required understanding and consideration of engagement risk is less than in a reasonable assurance engagement.

A177. Factors to consider in determining the level of detail to be provided in the summary of the work performed may include:

- Circumstances specific to the entity (for example, the differing nature of the entity's activities compared to those typical in the sector).
- Specific engagement circumstances affecting the nature and extent of the procedures performed.
- The intended users' expectations of the level of detail to be provided in the report, based on market practice, or applicable law or regulation.

A178. It is important that the summary be written in an objective way that allows intended users to understand the work done as the basis for the practitioner's conclusion. In most cases, this will not involve detailing the entire work plan, but on the other hand it is important for it not to be so summarized as to be ambiguous, nor written in a way that is overstated or embellished.

The Practitioner's Conclusion (Ref: Para. 12(a)(i)(a), 69(l))

A179. Examples of conclusions expressed in a form appropriate for a reasonable assurance engagement include:

- When expressed in terms of the underlying subject matter and the applicable criteria, "In our opinion, the entity has complied, in all material respects, with XYZ law;"
- When expressed in terms of the subject matter information and the applicable criteria, "In our opinion, the forecast of the entity's financial performance is properly prepared, in all material respects, based on XYZ criteria;" or
- When expressed in terms of a statement made by the appropriate party, "In our opinion, the [appropriate party's] statement that the entity has complied with XYZ law is, in all material respects, fairly stated," or "In our opinion, the [appropriate party's] statement that the key performance indicators are presented in accordance with XYZ criteria is, in all material respects, fairly stated."

A180. It may be appropriate to inform the intended users of the context in which the practitioner's conclusion is to be read when the assurance report includes an explanation of particular characteristics of the underlying subject matter of which the intended users should be aware. The practitioner's conclusion may, for example, include wording such as: "This conclusion has been formed on the basis of the matters outlined elsewhere in this independent assurance report."

A181. Examples of conclusions expressed in a form appropriate for a limited assurance engagement include:

- When expressed in terms of the underlying subject matter and the applicable criteria, "Based on the procedures performed and evidence obtained, nothing has come to our attention that causes us to believe that [the entity] has not complied, in all material respects, with XYZ law."
- When expressed in terms of the subject matter information and the applicable criteria, "Based on the procedures performed and evidence obtained, we are not aware of any material amendments that need to be made to the assessment of key performance indicators for them to be in accordance with XYZ criteria."
- When expressed in terms of a statement made by the appropriate party, "Based on the procedures performed and evidence obtained, nothing has come to our attention that

causes us to believe that the [appropriate party's] statement that [the entity] has complied with XYZ law, is not, in all material respects, fairly stated."

A182. Forms of expression that may be useful for underlying subject matters include, for example, one, or a combination of, the following:

- For compliance engagements—"in compliance with" or "in accordance with."
- For engagements when the applicable criteria describe a process or methodology for the preparation or presentation of the subject matter information—"properly prepared."
- For engagements when the principles of fair presentation are embodied in the applicable criteria—"fairly stated."

A183. Inclusion of a heading above paragraphs containing modified conclusions, and the matter(s) giving rise to the modification, aids the understandability of the practitioner's report. Examples of appropriate heading include "Qualified Conclusion," "Adverse Conclusion," or "Disclaimer of Conclusion" and "Basis for Qualified Conclusion," "Basis for Adverse Conclusion," as appropriate.

The Practitioner's Signature (Ref: Para. 69(m))

A184. The practitioner's signature is either in the name of the practitioner's firm, the personal name of the individual practitioner or both, as appropriate for the particular jurisdiction. In addition to the practitioner's signature, in certain jurisdictions, the practitioner may be required to make a declaration in the practitioner's report about professional designations or recognition by the appropriate licensing authority in that jurisdiction.

Date (Ref: Para. 69(n))

A185. Including the assurance report date informs the intended users that the practitioner has considered the effect on the subject matter information and on the assurance report of events that occurred up to that date.

Reference to the Practitioner's Expert in the Assurance Report (Ref: Para. 70)

A186. In some cases, law or regulation may require a reference to the work of a practitioner's expert in the assurance report, for example, for the purposes of transparency in the public sector. It may also be appropriate in other circumstances, for example, to explain the nature of a modification of the practitioner's conclusion, or when the work of an expert is integral to findings included in a long-form report.

A187. Nonetheless, the practitioner has sole responsibility for the conclusion expressed, and that responsibility is not reduced by the practitioner's use of the work of a practitioner's expert. It is important therefore that if the assurance report refers to a practitioner's expert, that the wording of that report does not imply that the practitioner's responsibility for the conclusion expressed is reduced because of the involvement of that expert.

A188. A generic reference in a long-form report to the engagement having been conducted by suitably qualified personnel including subject matter experts and assurance specialists is unlikely to be misunderstood as reduced responsibility. The potential for misunderstanding is higher, however, in the case of short-form reports, where minimum contextual information is able to be presented, or when the practitioner's expert is referred to by name. Therefore, additional wording may be needed in such cases to prevent the assurance report implying that the practitioner's responsibility for the conclusion expressed is reduced because of the involvement of the expert.

Unmodified and Modified Conclusions (Ref: Para. 74–77, Appendix)

A189. The term 'pervasive' describes the effects on the subject matter information of misstatements or the possible effects on the subject matter information of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate evidence. Pervasive effects on the subject matter information are those that, in the practitioner's professional judgment:

(a) Are not confined to specific aspects of the subject matter information;

(b) If so confined, represent or could represent a substantial proportion of the subject matter information; or

(c) In relation to disclosures, are fundamental to the intended users' understanding of the subject matter information.

A190. The nature of the matter, and the practitioner's judgment about the pervasiveness of the effects or possible effects on the subject matter information, affects the type of conclusion to be expressed.

A191. Examples of qualified and adverse conclusions and a disclaimer of conclusion are:

- Qualified conclusion (an example for limited assurance engagements with a material misstatement) – "Based on the procedures performed and the evidence obtained, except for the effect of the matter described in the Basis for Qualified Conclusion section of our report, nothing has come to our attention that causes us to believe that the [appropriate party's] statement does not present fairly, in all material respects, the entity's compliance with XYZ law."

- Adverse conclusion (an example for a material and pervasive misstatement for both reasonable assurance and limited assurance engagements) – "Because of the significance of the matter described in the Basis for Adverse Conclusion section of our report, the [appropriate party's] statement does not present fairly the entity's compliance with XYZ law."

- Disclaimer of conclusion (an example for a material and pervasive limitation of scope for both reasonable assurance and limited assurance engagements) – "Because of the significance of the matter described in the Basis for Disclaimer of Conclusion section of our report, we have not been able to obtain sufficient appropriate evidence to form a conclusion on the [appropriate party's] statement. Accordingly, we do not express a conclusion on that statement."

A192. In some cases, the measurer or evaluator may identify and properly describe that the subject matter information is materially misstated. For example, in a compliance engagement the measurer or evaluator may correctly describe the instances of non-compliance. In such circumstances, paragraph 76 requires the practitioner to draw the intended users' attention to the description of the material misstatement, by either expressing a qualified or adverse conclusion or by expressing an unqualified conclusion but emphasizing the matter by specifically referring to it in the assurance report.

Other Communication Responsibilities (Ref: Para. 78)

A193. Matters that may be appropriate to communicate with the responsible party, the measurer or evaluator, the engaging party or others include fraud or suspected fraud, and bias in the preparation of the subject matter information.

Communication with Management and Those Charged with Governance

A194. Relevant ethical requirements may include a requirement to report identified or suspected non-compliance with laws and regulations to an appropriate level of management or those charged with governance. In some jurisdictions, law or regulation may restrict the practitioner's communication of certain matters with the responsible party, management or those charged with governance. Law or regulation may specifically prohibit a communication, or other action, that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act, including alerting the entity, for example, when the practitioner is required to report the identified or suspected non-compliance to an appropriate authority pursuant to anti-money laundering legislation. [7a] In these circumstances, the issues considered by the practitioner may be complex and the practitioner may consider it appropriate to obtain legal advice.

Reporting of Identified or Suspected Non-Compliance with Laws and Regulations to an Appropriate Authority outside the Entity

A195. Law, regulation or relevant ethical requirements may:

(a) Require the practitioner to report identified or suspected non-compliance with laws and regulations to an appropriate authority outside the entity.

(b) Establish responsibilities under which reporting to an appropriate authority outside the entity may be appropriate in the circumstances.[8]

A196. Reporting identified or suspected non-compliance with laws and regulations to an appropriate authority outside the entity may be required or appropriate in the circumstances because:

(a) Law, regulation or relevant ethical requirements require the practitioner to report;

(b) The practitioner has determined reporting is an appropriate action to respond to identified or suspected non-compliance in accordance with relevant ethical requirements; or~~.~~

(c) Law, regulation or relevant ethical requirements provide the practitioner with the right to do so.

A197. The reporting of identified or suspected non-compliance with laws and regulations in accordance with law, regulation or relevant ethical requirements may include non-compliance with laws and regulations that the practitioner comes across or is made aware of when performing the engagement but which may not affect the subject matter information. Under this HKSAE, the practitioner is not expected to have a level of understanding of laws and regulations beyond those affecting the subject matter information. However, law, regulation or relevant ethical requirements may expect the practitioner to apply knowledge, professional judgment and expertise in responding to such non-compliance. Whether an act constitutes actual non-compliance is ultimately a matter to be determined by a court or other appropriate adjudicative body.

A198. In some circumstances, the reporting of identified or suspected non-compliance with laws and regulations to an appropriate authority outside the entity may be precluded by the practitioner's duty of confidentiality under law, regulation, or relevant ethical requirements. In other cases, reporting identified or suspected non-compliance to an appropriate authority outside the entity would not be considered a breach of the duty of confidentiality under the relevant ethical requirements.[9]

A199. The practitioner may consider consulting internally (e.g., within the firm or network firm), obtaining legal advice to understand the professional or legal implications of taking any particular course of action, or consulting on a confidential basis with a regulator or a professional body (unless doing so is prohibited by law or regulations or would breach the duty of confidentiality).[10]

Documentation (Ref: Para. 79–83)

A200. Documentation includes a record of the practitioner's reasoning on all significant matters that require the exercise of professional judgment, and related conclusions. When difficult questions of principle or professional judgment exist, documentation that includes the relevant facts that were known by the practitioner at the time the conclusion was reached may assist in demonstrating the practitioner's knowledge.

[7a] Additional guidance is provided in Appendix 4 of HKSA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*.

[8] See, for example, Sections 225.51-225.52 of the Code.

[9] See, for example, Section 140.7 and Section 225.53 of the Code.

[10] See, for example, Section 225.55 of the Code.

A201. It is neither necessary nor practical to document every matter considered, or professional judgment made, during an engagement. Further, it is unnecessary for the practitioner to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included within the engagement file. Similarly, the practitioner need not include in the engagement file superseded drafts of working papers, notes that reflect incomplete or preliminary thinking, previous copies of documents corrected for typographical or other errors, and duplicates of documents.

A202. In applying professional judgment to assessing the extent of documentation to be prepared and retained, the practitioner may consider what is necessary to provide an understanding of the work performed and the basis of the principal decisions taken (but not the detailed aspects of the engagement) to another practitioner who has no previous experience with the engagement. That other practitioner may only be able to obtain an understanding of detailed aspects of the engagement by discussing them with the practitioner who prepared the documentation.

A203. Documentation may include a record of, for example:

- The identifying characteristics of the specific items or matters tested;
- Who performed the engagement work and the date such work was completed;
- Who reviewed the engagement work performed and the date and extent of such review; and
- Discussions of significant matters with the appropriate party(ies) and others, including the nature of the significant matters discussed and when and with whom the discussions took place.

A204. Documentation may include a record of, for example:

- Issues identified with respect to compliance with relevant ethical requirements and how they were resolved.
- Conclusions on compliance with independence requirements that apply to the engagement, and any relevant discussions with the firm that support these conclusions.
- Conclusions reached regarding the acceptance and continuance of client relationships and assurance engagements.
- The nature and scope of, and conclusions resulting from, consultations undertaken during the course of the engagement.

Assembly of the Final Engagement File

A205. HKSQC 1 (or other professional requirements, or requirements in law or regulation that are at least as demanding as HKSQC 1) requires firms to establish policies and procedures for the timely completion of the assembly of engagement files.[11] An appropriate time limit within which to complete the assembly of the final engagement file is ordinarily not more than 60 days after the date of the assurance report.[12]

A206. The completion of the assembly of the final engagement file after the date of the assurance report is an administrative process that does not involve the performance of new procedures or the drawing of new conclusions. Changes may, however, be made to the documentation during the final assembly process if they are administrative in nature. Examples of such changes include:

- Deleting or discarding superseded documentation.
- Sorting, collating and cross-referencing working papers.

[11] HKSQC 1, paragraph 45

[12] HKSQC 1, paragraph A54

- Signing off on completion checklists relating to the file assembly process.

- Documenting evidence that the practitioner has obtained, discussed and agreed with the relevant members of the engagement team before the date of the assurance report.

A207. HKSQC 1 (or national requirements that are at least as demanding as HKSQC 1) requires firms to establish policies and procedures for the retention of engagement documentation.[13] The retention period for assurance engagements ordinarily is no shorter than five years from the date of the assurance report.[14]

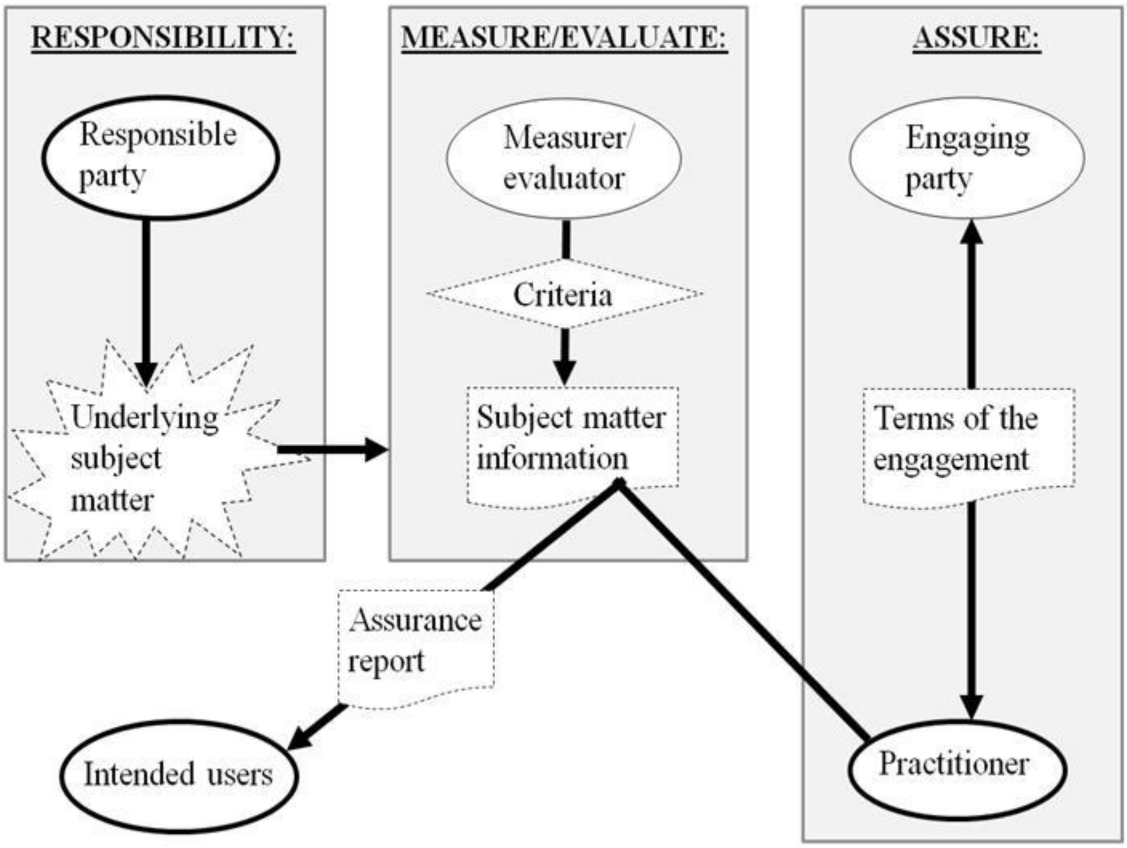
[13] HKSQC 1, paragraph 47

[14] HKSQC 1, paragraph A61

Appendix

(Ref: Para. 2, A8, A11, A16, A36–A38)

Roles and Responsibilities



1. All assurance engagements have at least three parties: the responsible party, the practitioner, and the intended users. Depending on the engagement circumstances, there may also be a separate role of measurer or evaluator, or engaging party.

2. The above diagram illustrates how the following roles relate to an assurance engagement:

   (a) The responsible party is responsible for the underlying subject matter.

   (b) The measurer or evaluator uses the criteria to measure or evaluate the underlying subject matter resulting in the subject matter information.

   (c) The engaging party agrees the terms of the engagement with the practitioner.

   (d) The practitioner obtains sufficient appropriate evidence in order to express a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the subject matter information.

   (e) The intended users make decisions on the basis of the subject matter information. The intended users are the individual(s) or organization(s), or group(s) thereof that the practitioner expects will use the assurance report.

3. The following observations can be made about these roles:

   - Every assurance engagement has at least a responsible party and intended users, in addition to the practitioner.

- The practitioner cannot be the responsible party, the engaging party or an intended user.
- In a direct engagement, the practitioner is also the measurer or evaluator.
- In an attestation engagement, the responsible party, or someone else, but not the practitioner, can be the measurer or evaluator.
- When the practitioner has measured or evaluated the underlying subject matter against the criteria, the engagement is a direct engagement. The character of that engagement cannot be changed to an attestation engagement by another party assuming responsibility for the measurement or evaluation, for example, by the responsible party attaching a statement to the subject matter information accepting responsibility for it.
- The responsible party can be the engaging party.
- In many attestation engagements the responsible party may also be the measurer or evaluator, and the engaging party. An example is when an entity engages a practitioner to perform an assurance engagement regarding a report it has prepared about its own sustainability practices. An example of when the responsible party is different from the measurer or evaluator, is when the practitioner is engaged to perform an assurance engagement regarding a report prepared by a government organization about a private company's sustainability practices.
- In an attestation engagement, the measurer or evaluator ordinarily provides the practitioner with a written representation about the subject matter information. In some cases, the practitioner may not be able to obtain such a representation, for example, when the engaging party is not the measurer or evaluator.
- The responsible party can be one of the intended users, but not the only one.
- The responsible party, the measurer or evaluator, and the intended users may be from different entities or the same entity. As an example of the latter case, in a two-tier board structure, the supervisory board may seek assurance about information provided by the executive board of that entity. The relationship between the responsible party, the measurer or evaluator, and the intended users' needs to be viewed within the context of a specific engagement and may differ from more traditionally defined lines of responsibility. For example, an entity's senior management (an intended user) may engage a practitioner to perform an assurance engagement on a particular aspect of the entity's activities that is the immediate responsibility of a lower level of management (the responsible party), but for which senior management is ultimately responsible.
- An engaging party that is not also the responsible party can be the intended user.

4. The practitioner's conclusion may be phrased either in terms of:
   - The underlying subject matter and the applicable criteria;
   - The subject matter information and the applicable criteria; or
   - A statement made by the appropriate party.

5. The practitioner and the responsible party may agree to apply the principles of the HKSAEs to an engagement when there are no intended users other than the responsible party but where all other requirements of the HKSAEs are met. In such cases, the practitioner's report includes a statement restricting the use of the report to the responsible party.

HKSAE 3402
Issued May 2010, Revised December 2012, March 2014,
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Effective for service auditors' assurance reports
covering periods ending on or after 15 June 2011

Hong Kong Standard on Assurance Engagements 3402

Assurance Reports on Controls at a Service Organization

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

HONG KONG STANDARD ON ASSURANCE ENGAGEMENTS (HKSAE) 3402 ASSURANCE REPORTS ON CONTROLS AT A SERVICE ORGANIZATION

(Effective for service auditors' assurance reports covering periods ending on or after 15 June 2011)

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Hong Kong Standard on Assurance Engagements (HKSAE) 3402, "Assurance Reports on Controls at a Service Organization," should be read in conjunction with the "Preface to Hong Kong Standards on Quality Control, Auditing, Review, Other Assurance and Related Services."

Introduction

Scope of this HKSAE

1. This Hong Kong Standard on Assurance Engagements (HKSAE) deals with assurance engagements undertaken by a practitioner[1] to provide a report for use by user entities and their auditors on the controls at a service organization that provides a service to user entities that is likely to be relevant to user entities' internal control as it relates to financial reporting. It complements HKSA 402,[2] in that reports prepared in accordance with this HKSAE are capable of providing appropriate evidence under HKSA 402. (Ref: Para. A1)

2. The "Hong Kong Framework for Assurance Engagements" (the Assurance Framework) states that an assurance engagement may be a "reasonable assurance" engagement or a "limited assurance" engagement and that an assurance engagement may be either an attestation engagement or a "direct" engagement.[3] This HKSAE only deals with reasonable assurance attestation engagements.[4]

3. This HKSAE applies only when the service organization is responsible for, or otherwise able to make a statement about, the suitable design of controls. This HKSAE does not deal with assurance engagements:

   (a) To report only on whether controls at a service organization operated as described, or

   (b) To report on controls at a service organization other than those related to a service that is likely to be relevant to user entities' internal control as it relates to financial reporting (for example, controls that affect user entities' production or quality control).

   This HKSAE, however, provides some guidance for such engagements carried out under HKSAE 3000 (Revised). (Ref: Para. A2)

4. In addition to issuing an assurance report on controls, a service auditor may also be engaged to provide reports such as the following, which are not dealt with in this HKSAE:

   (a) A report on a user entity's transactions or balances maintained by a service organization; or

   (b) An agreed-upon procedures report on controls at a service organization.

Relationship with HKSAE 3000 (Revised), Other Professional Pronouncements and Other Requirements

5. The service auditor is required to comply with HKSAE 3000 (Revised) and this HKSAE when performing assurance engagements on controls at a service organization. This HKSAE supplements, but does not replace, HKSAE 3000 (Revised), and expands on how HKSAE 3000 (Revised) is to be applied in a reasonable assurance engagement to report on controls at a service organization.

6. Compliance with HKSAE 3000 (Revised) requires, among other things, compliance with Parts A, B and D of the HKICPA's *Code of Ethics for Professional Accountants* (the Code) related to assurance engagements, or other professional requirements, or requirements imposed by law and

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[1] HKSAE 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information,* paragraph 12(r)

[2] HKSA 402, *Audit Considerations Relating to an Entity Using a Service Organization*

[3] HKSAE 3000 (Revised), paragraph 12

[4] Paragraphs 13 and 53(k) of this HKSAE

regulation, that are at least as demanding.[5] It also requires the engagement partner to be a member of a firm that applies HKSQC 1,[6] or other professional requirements, or requirements in law or regulation, that are at least as demanding as HKSQC 1.

Effective Date

7. This HKSAE is effective for service auditors' assurance reports covering periods ending on or after 15 June 2011.

Objectives

8. The objectives of the service auditor are:

   (a) To obtain reasonable assurance about whether, in all material respects, based on suitable criteria:

      (i) The service organization's description of its system fairly presents the system as designed and implemented throughout the specified period (or in the case of a type 1 report, as at a specified date);

      (ii) The controls related to the control objectives stated in the service organization's description of its system were suitably designed throughout the specified period (or in the case of a type 1 report, as at a specified date);

      (iii) Where included in the scope of the engagement, the controls operated effectively to provide reasonable assurance that the control objectives stated in the service organization's description of its system were achieved throughout the specified period.

   (b) To report on the matters in (a) above in accordance with the service auditor's findings.

Definitions

9. For purposes of this HKSAE, the following terms have the meanings attributed below:

   (a) Carve-out method – Method of dealing with the services provided by a subservice organization, whereby the service organization's description of its system includes the nature of the services provided by a subservice organization, but that subservice organization's relevant control objectives and related controls are excluded from the service organization's description of its system and from the scope of the service auditor's engagement. The service organization's description of its system and the scope of the service auditor's engagement include controls at the service organization to monitor the effectiveness of controls at the subservice organization, which may include the service organization's review of an assurance report on controls at the subservice organization.

   (b) Complementary user entity controls – Controls that the service organization assumes, in the design of its service, will be implemented by user entities, and which, if necessary to achieve control objectives stated in the service organization's description of its system, are identified in that description.

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5 HKSAE 3000 (Revised), paragraphs 3(a), 20 and 34

6 HKSAE 3000 (Revised), paragraphs 3(b) and 31(a). Hong Kong Standard on Quality Control (HKSQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

(c) Control objective – The aim or purpose of a particular aspect of controls. Control objectives relate to risks that controls seek to mitigate.

(d) Controls at the service organization – Controls over the achievement of a control objective that is covered by the service auditor’s assurance report. (Ref: Para. A3)

(e) Controls at a subservice organization – Controls at a subservice organization to provide reasonable assurance about the achievement of a control objective.

(f) Criteria – Benchmarks used to evaluate or measure the underlying subject matter. The “applicable criteria” are the criteria used for the particular engagement.

(g) Inclusive method – Method of dealing with the services provided by a subservice organization, whereby the service organization’s description of its system includes the nature of the services provided by a subservice organization, and that subservice organization’s relevant control objectives and related controls are included in the service organization’s description of its system and in the scope of the service auditor’s engagement. (Ref: Para. A4)

(h) Internal audit function – A function of an entity that performs assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management and internal control processes.

(i) Internal auditors – Those individuals who perform the activities of the internal audit function. Internal auditors may belong to an internal audit department or equivalent function.

(j) Report on the description and design of controls at a service organization (referred to in this HKSAE as a “type 1 report”) – A report that comprises:

    (i) The service organization’s description of its system;

    (ii) A written statement by the service organization that, in all material respects, and based on suitable criteria:

        a. The description fairly presents the service organization’s system as designed and implemented as at the specified date;

        b. The controls related to the control objectives stated in the service organization’s description of its system were suitably designed as at the specified date; and

    (iii) A service auditor’s assurance report that conveys a reasonable assurance conclusion about the matters in (ii)a.-b. above.

(k) Report on the description, design and operating effectiveness of controls at a service organization (referred to in this HKSAE as a “type 2 report”) – A report that comprises:

    (i) The service organization’s description of its system;

    (ii) A written statement by the service organization that, in all material respects, and based on suitable criteria:

        a. The description fairly presents the service organization’s system as designed and implemented throughout the specified period;

b. The controls related to the control objectives stated in the service organization's description of its system were suitably designed throughout the specified period; and

c. The controls related to the control objectives stated in the service organization's description of its system operated effectively throughout the specified period; and

(iii) A service auditor's assurance report that:

a. Conveys a reasonable assurance conclusion about the matters in (ii)a.-c. above; and

b. Includes a description of the tests of controls and the results thereof.

(l) Service auditor – A practitioner who, at the request of the service organization, provides an assurance report on controls at a service organization.

(m) Service organization – A third-party organization (or segment of a third-party organization) that provides services to user entities that are likely to be relevant to user entities' internal control as it relates to financial reporting.

(n) Service organization's system (or the system) – The policies and procedures designed and implemented by the service organization to provide user entities with the services covered by the service auditor's assurance report. The service organization's description of its system includes identification of: the services covered; the period, or in the case of a type 1 report, the date, to which the description relates; control objectives; and related controls.

(o) Service organization's statement – The written statement about the matters referred to in paragraph 9(k)(ii) (or paragraph 9(j)(ii) in the case of a type 1 report).

(p) Subservice organization – A service organization used by another service organization to perform some of the services provided to user entities that are likely to be relevant to user entities' internal control as it relates to financial reporting.

(q) Test of controls – A procedure designed to evaluate the operating effectiveness of controls in achieving the control objectives stated in the service organization's description of its system.

(r) User auditor – An auditor who audits and reports on the financial statements of a user entity.[7]

(s) User entity – An entity that uses a service organization.

Requirements

HKSAE 3000 (Revised)

10. The service auditor shall not represent compliance with this HKSAE unless the service auditor has complied with the requirements of this HKSAE and HKSAE 3000 (Revised).

[7] In the case of a subservice organization, the service auditor of a service organization that uses the services of the subservice organization is also a user auditor.

Ethical Requirements

11. The service auditor shall comply with Parts A, B and D of the Code relating to assurance engagements, or other professional requirements, or requirements imposed by law or regulation, that are at least as demanding. (Ref: Para. A5)

Management and Those Charged with Governance

12. Where this HKSAE requires the service auditor to inquire of, request representations from, communicate with, or otherwise interact with the service organization, the service auditor shall determine the appropriate person(s) within the service organization's management or governance structure with whom to interact. This shall include consideration of which person(s) have the appropriate responsibilities for and knowledge of the matters concerned. (Ref: Para. A6)

Acceptance and Continuance

13. Before agreeing to accept, or continue, an engagement the service auditor shall:

    (a) Determine whether:

        (i) The service auditor has the capabilities and competence to perform the engagement; (Ref: Para. A7)

        (ii) The criteria the practitioner expects to be applied by the service organization to prepare the description of its system are suitable and will be available to user entities and their auditors; and

        (iii) The scope of the engagement and the service organization's description of its system will not be so limited that they are unlikely to be useful to user entities and their auditors.

    (b) Obtain the agreement of the service organization that it acknowledges and understands its responsibility:

        (i) For the preparation of the description of its system, and accompanying service organization's statement, including the completeness, accuracy and method of presentation of that description and statement; (Ref: Para. A8)

        (ii) To have a reasonable basis for the service organization's statement accompanying the description of its system; (Ref: Para. A9)

        (iii) For stating in the service organization's statement the criteria it used to prepare the description of its system;

        (iv) For stating in the description of its system:

            a. The control objectives; and

            b. Where they are specified by law or regulation, or another party (for example, a user group or a professional body), the party who specified them;

        (v) For identifying the risks that threaten achievement of the control objectives stated in the description of its system, and designing and implementing controls to provide reasonable assurance that those risks will not prevent achievement of the control objectives stated in the description of its system, and therefore that the stated control objectives will be achieved; and (Ref: Para. A10)

(vi) To provide the service auditor with:

a. Access to all information, such as records, documentation and other matters, including service level agreements, of which the service organization is aware that is relevant to the description of the service organization's system and the accompanying service organization's statement;

b. Additional information that the service auditor may request from the service organization for the purpose of the assurance engagement; and

c. Unrestricted access to persons within the service organization from whom the service auditor determines it necessary to obtain evidence.

Acceptance of a Change in the Terms of the Engagement

14. If the service organization requests a change in the scope of the engagement before the completion of the engagement, the service auditor shall be satisfied that there is a reasonable justification for the change. (Ref: Para. A11-A12)

Determining the Suitability of the Criteria

15. The service auditor shall determine whether the service organization has used suitable criteria in preparing the description of its system, in evaluating whether controls are suitably designed, and, in the case of a type 2 report, in evaluating whether controls are operating effectively.

16. In determining the suitability of the criteria to evaluate the service organization's description of its system, the service auditor shall determine if the criteria encompass, at a minimum:

(a) Whether the description presents how the service organization's system was designed and implemented, including, as appropriate:

(i) The types of services provided, including, as appropriate, classes of transactions processed;

(ii) The procedures, within both information technology and manual systems, by which services are provided, including, as appropriate, procedures by which transactions are initiated, recorded, processed, corrected as necessary, and transferred to the reports and other information prepared for user entities;

(iii) The related records and supporting information, including, as appropriate, accounting records, supporting information and specific accounts that are used to initiate, record, process and report transactions; this includes the correction of incorrect information and how information is transferred to the reports and other information prepared for user entities;

(iv) How the service organization's system deals with significant events and conditions, other than transactions;

(v) The process used to prepare reports and other information for user entities;

(vi) The specified control objectives and controls designed to achieve those objectives;

(vii) Complementary user entity controls contemplated in the design of the controls; and

(viii) Other aspects of the service organization's control environment, risk assessment process, information system (including the related business processes) and communication, control activities and monitoring controls that are relevant to the services provided.

(b) In the case of a type 2 report, whether the description includes relevant details of changes to the service organization's system during the period covered by the description.

(c) Whether the description omits or distorts information relevant to the scope of the service organization's system being described, while acknowledging that the description is prepared to meet the common needs of a broad range of user entities and their auditors and may not, therefore, include every aspect of the service organization's system that each individual user entity and its auditor may consider important in its particular environment.

17. In determining the suitability of the criteria to evaluate the design of controls, the service auditor shall determine if the criteria encompass, at a minimum, whether:

(a) The service organization has identified the risks that threaten achievement of the control objectives stated in the description of its system; and

(b) The controls identified in that description would, if operated as described, provide reasonable assurance that those risks do not prevent the stated control objectives from being achieved.

18. In determining the suitability of the criteria to evaluate the operating effectiveness of controls in providing reasonable assurance that the stated control objectives identified in the description will be achieved, the service auditor shall determine if the criteria encompass, at a minimum, whether the controls were consistently applied as designed throughout the specified period. This includes whether manual controls were applied by individuals who have the appropriate competence and authority. (Ref: Para. A13-A15)

Materiality

19. When planning and performing the engagement, the service auditor shall consider materiality with respect to the fair presentation of the description, the suitability of the design of controls and, in the case of a type 2 report, the operating effectiveness of controls. (Ref: Para. A16-A18)

Obtaining an Understanding of the Service Organization's System

20. The service auditor shall obtain an understanding of the service organization's system, including controls that are included in the scope of the engagement. (Ref: Para. A19-A20)

Obtaining Evidence Regarding the Description

21. The service auditor shall obtain and read the service organization's description of its system, and shall evaluate whether those aspects of the description included in the scope of the engagement are fairly presented, including whether: (Ref: Para. A21-A22)

(a) Control objectives stated in the service organization's description of its system are reasonable in the circumstances; (Ref: Para. A23)

(b) Controls identified in that description were implemented;

(c) Complementary user entity controls, if any, are adequately described; and

(d) Services performed by a subservice organization, if any, are adequately described, including whether the inclusive method or the carve-out method has been used in relation to them.

22. The service auditor shall determine, through other procedures in combination with inquiries, whether the service organization's system has been implemented. Those other procedures shall include observation, and inspection of records and other documentation, of the manner in which the service organization's system operates and controls are applied. (Ref: Para. A24)

Obtaining Evidence Regarding Design of Controls

23. The service auditor shall determine which of the controls at the service organization are necessary to achieve the control objectives stated in the service organization's description of its system, and shall assess whether those controls were suitably designed. This determination shall include: (Ref: Para. A25-A27)

    (a) Identifying the risks that threaten the achievement of the control objectives stated in the service organization's description of its system; and

    (b) Evaluating the linkage of controls identified in the service organization's description of its system with those risks.

Obtaining Evidence Regarding Operating Effectiveness of Controls

24. When providing a type 2 report, the service auditor shall test those controls that the service auditor has determined are necessary to achieve the control objectives stated in the service organization's description of its system, and assess their operating effectiveness throughout the period. Evidence obtained in prior engagements about the satisfactory operation of controls in prior periods does not provide a basis for a reduction in testing, even if it is supplemented with evidence obtained during the current period. (Ref: Para. A28-A32)

25. When designing and performing tests of controls, the service auditor shall:

    (a) Perform other procedures in combination with inquiry to obtain evidence about:

        (i) How the control was applied;

        (ii) The consistency with which the control was applied; and

        (iii) By whom or by what means the control was applied;

    (b) Determine whether controls to be tested depend upon other controls (indirect controls) and, if so, whether it is necessary to obtain evidence supporting the operating effectiveness of those indirect controls; and (Ref: Para. A33-A34)

    (c) Determine means of selecting items for testing that are effective in meeting the objectives of the procedure. (Ref: Para. A35-A36)

26. When determining the extent of tests of controls, the service auditor shall consider matters including the characteristics of the population to be tested, which includes the nature of controls, the frequency of their application (for example, monthly, daily, a number of times per day), and the expected rate of deviation.

Sampling

27. When the service auditor uses sampling, the service auditor shall: (Ref: Para. A35-A36)

(a) Consider the purpose of the procedure and the characteristics of the population from which the sample will be drawn when designing the sample;

(b) Determine a sample size sufficient to reduce sampling risk to an appropriately low level;

(c) Select items for the sample in such a way that each sampling unit in the population has a chance of selection;

(d) If a designed procedure is not applicable to a selected item, perform the procedure on a replacement item; and

(e) If unable to apply the designed procedures, or suitable alternative procedures, to a selected item, treat that item as a deviation.

Nature and Cause of Deviations

28. The service auditor shall investigate the nature and cause of any deviations identified and shall determine whether:

(a) Identified deviations are within the expected rate of deviation and are acceptable; therefore, the testing that has been performed provides an appropriate basis for concluding that the control is operating effectively throughout the specified period;

(b) Additional testing of the control or of other controls is necessary to reach a conclusion on whether the controls relative to a particular control objective are operating effectively throughout the specified period; or (Ref: Para. A25)

(c) The testing that has been performed provides an appropriate basis for concluding that the control did not operate effectively throughout the specified period.

29. In the extremely rare circumstances when the service auditor considers a deviation discovered in a sample to be an anomaly and no other controls have been identified that allow the service auditor to conclude that the relevant control objective is operating effectively throughout the specified period, the service auditor shall obtain a high degree of certainty that such deviation is not representative of the population. The service auditor shall obtain this degree of certainty by performing additional procedures to obtain sufficient appropriate evidence that the deviation does not affect the remainder of the population.

The Work of an Internal Audit Function[8]

Obtaining an Understanding of the Internal Audit Function

30. If the service organization has an internal audit function, the service auditor shall obtain an understanding of the nature of the responsibilities of the internal audit function and of the activities performed in order to determine whether the internal audit function is likely to be relevant to the engagement. (Ref: Para. A37)

Determining Whether and to What Extent to Use the Work of the Internal Auditors

31. The service auditor shall determine:

[8] This HKSAE does not deal with instances when individual internal auditors provide direct assistance to the service auditor in carrying out audit procedures.

(a) Whether the work of the internal auditors is likely to be adequate for purposes of the engagement; and

(b) If so, the planned effect of the work of the internal auditors on the nature, timing or extent of the service auditor's procedures.

32. In determining whether the work of the internal auditors is likely to be adequate for purposes of the engagement, the service auditor shall evaluate:

(a) The objectivity of the internal audit function;

(b) The technical competence of the internal auditors;

(c) Whether the work of the internal auditors is likely to be carried out with due professional care; and

(d) Whether there is likely to be effective communication between the internal auditors and the service auditor.

33. In determining the planned effect of the work of the internal auditors on the nature, timing or extent of the service auditor's procedures, the service auditor shall consider: (Ref: Para. A38)

(a) The nature and scope of specific work performed, or to be performed, by the internal auditors;

(b) The significance of that work to the service auditor's conclusions; and

(c) The degree of subjectivity involved in the evaluation of the evidence gathered in support of those conclusions.

Using the Work of the Internal Audit Function

34. In order for the service auditor to use specific work of the internal auditors, the service auditor shall evaluate and perform procedures on that work to determine its adequacy for the service auditor's purposes. (Ref: Para. A39)

35. To determine the adequacy of specific work performed by the internal auditors for the service auditor's purposes, the service auditor shall evaluate whether:

(a) The work was performed by internal auditors having adequate technical training and proficiency;

(b) The work was properly supervised, reviewed and documented;

(c) Adequate evidence has been obtained to enable the internal auditors to draw reasonable conclusions;

(d) Conclusions reached are appropriate in the circumstances and any reports prepared by the internal auditors are consistent with the results of the work performed; and

(e) Exceptions relevant to the engagement or unusual matters disclosed by the internal auditors are properly resolved.

Effect on the Service Auditor's Assurance Report

36. If the work of the internal audit function has been used, the service auditor shall make no reference to that work in the section of the service auditor's assurance report that contains the service auditor's opinion. (Ref: Para. A40)

37. In the case of a type 2 report, if the work of the internal audit function has been used in performing tests of controls, that part of the service auditor's assurance report that describes the service auditor's tests of controls and the results thereof shall include a description of the internal auditor's work and of the service auditor's procedures with respect to that work. (Ref: Para. A41)

Written Representations

38. The service auditor shall request the service organization to provide written representations: (Ref: Para. A42)

    (a) That reaffirm the statement accompanying the description of the system;

    (b) That it has provided the service auditor with all relevant information and access agreed to;[9] and

    (c) That it has disclosed to the service auditor any of the following of which it is aware:

        (i) Non-compliance with law and regulations, fraud, or uncorrected deviations attributable to the service organization that may affect one or more user entities;

        (ii) Design deficiencies in controls;

        (iii) Instances where controls have not operated as described; and

        (iv) Any events subsequent to the period covered by the service organization's description of its system up to the date of the service auditor's assurance report that could have a significant effect on the service auditor's assurance report.

39. The written representations shall be in the form of a representation letter addressed to the service auditor. The date of the written representations shall be as near as practicable to, but not after, the date of the service auditor's assurance report.

40. If, having discussed the matter with the service auditor, the service organization does not provide one or more of the written representations requested in accordance with paragraph 38(a) and (b) of this HKSAE, the service auditor shall disclaim an opinion. (Ref: Para. A43)

Other Information

41. The service auditor shall read the other information, if any, included in a document containing the service organization's description of its system and the service auditor's assurance report, to identify material inconsistencies, if any, with that description. While reading the other information for the purpose of identifying material inconsistencies, the service auditor may become aware of an apparent misstatement of fact in that other information.

42. If the service auditor identifies a material inconsistency or becomes aware of an apparent misstatement of fact in the other information, the service auditor shall discuss the matter with

[9] Paragraph 13(b)(vi) of this HKSAE

the service organization. If the service auditor concludes that there is a material inconsistency or a misstatement of fact in the other information that the service organization refuses to correct, the service auditor shall take further appropriate action. (Ref: Para. A44-A45)

Subsequent Events

43. The service auditor shall inquire whether the service organization is aware of any events subsequent to the period covered by the service organization's description of its system up to the date of the service auditor's assurance report that may have caused the service auditor to amend the assurance report. If the service auditor is aware of such an event, and information about that event is not disclosed by the service organization, the service auditor shall disclose it in the service auditor's assurance report.

44. The service auditor has no obligation to perform any procedures regarding the description of the service organization's system, or the suitability of design or operating effectiveness of controls, after the date of the service auditor's assurance report.

Documentation

45. The service auditor shall prepare on a timely basis engagement documentation that provides a record of the basis for the assurance report that is sufficient and appropriate to enable an experienced service auditor, having no previous connection with the engagement, to understand:

    (a) The nature, timing, and extent of the procedures performed to comply with this HKSAE and applicable legal and regulatory requirements;

    (b) The results of the procedures performed, and the evidence obtained; and

    (c) Significant matters arising during the engagement, and the conclusions reached thereon and significant professional judgments made in reaching those conclusions.

46. In documenting the nature, timing and extent of procedures performed, the service auditor shall record:

    (a) The identifying characteristics of the specific items or matters being tested;

    (b) Who performed the work and the date such work was completed; and

    (c) Who reviewed the work performed and the date and extent of such review.

47. If the service auditor uses specific work of the internal auditors, the service auditor shall document the conclusions reached regarding the evaluation of the adequacy of the work of the internal auditors, and the procedures performed by the service auditor on that work.

48. The service auditor shall document discussions of significant matters with the service organization and others including the nature of the significant matters discussed and when and with whom the discussions took place.

49. If the service auditor has identified information that is inconsistent with the service auditor's final conclusion regarding a significant matter, the service auditor shall document how the service auditor addressed the inconsistency.

50. The service auditor shall assemble the documentation in an engagement file and complete the administrative process of assembling the final engagement file on a timely basis after the date of the service auditor's assurance report.[10]

51. After the assembly of the final engagement file has been completed, the service auditor shall not delete or discard documentation before the end of its retention period. (Ref: Para. A46)

52. If the service auditor finds it necessary to modify existing engagement documentation or add new documentation after the assembly of the final engagement file has been completed and that documentation does not affect the service auditor's report, the service auditor shall, regardless of the nature of the modifications or additions, document:

    (a) The specific reasons for making them; and

    (b) When and by whom they were made and reviewed.

Preparing the Service Auditor's Assurance Report

Content of the Service Auditor's Assurance Report

53. The service auditor's assurance report shall include, at a minimum, the following basic elements: (Ref: Para. A47)

    (a) A title that clearly indicates the report is an independent service auditor's assurance report.

    (b) An addressee.

    (c) Identification of:

        (i) The service organization's description of its system, and the service organization's statement, which includes the matters described in paragraph 9(k)(ii) for a type 2 report, or paragraph 9(j)(ii) for a type 1 report.

        (ii) Those parts of the service organization's description of its system, if any, that are not covered by the service auditor's opinion.

        (iii) If the description refers to the need for complementary user entity controls, a statement that the service auditor has not evaluated the suitability of design or operating effectiveness of complementary user entity controls, and that the control objectives stated in the service organization's description of its system can be achieved only if complementary user entity controls are suitably designed or operating effectively, along with the controls at the service organization.

        (iv) If services are performed by a subservice organization, the nature of activities performed by the subservice organization as described in the service organization's description of its system and whether the inclusive method or the carve-out method has been used in relation to them. Where the carve-out method has been used, a statement that the service organization's description of its system excludes the control objectives and related controls at relevant subservice organizations, and that the service auditor's procedures do not extend to controls at the subservice organization. Where the inclusive method has been used, a statement that the service organization's description of its

[10] Paragraphs A54-A55 of HKSQC 1 provide further guidance.

system includes control objectives and related controls at the subservice organization, and that the service auditor's procedures extended to controls at the subservice organization.

(d) Identification of the applicable criteria, and the party specifying the control objectives.

(e) A statement that the report and, in the case of a type 2 report, the description of tests of controls are intended only for user entities and their auditors, who have a sufficient understanding to consider it, along with other information including information about controls operated by user entities themselves, when assessing the risks of material misstatements of user entities' financial statements. (Ref: Para. A48)

(f) A statement that the service organization is responsible for:

(i) Preparing the description of its system, and the accompanying statement, including the completeness, accuracy and method of presentation of that description and that statement;

(ii) Providing the services covered by the service organization's description of its system;

(iii) Stating the control objectives (where not identified by law or regulation, or another party, for example, a user group or a professional body); and

(iv) Designing and implementing controls to achieve the control objectives stated in the service organization's description of its system.

(g) A statement that the service auditor's responsibility is to express an opinion on the service organization's description, on the design of controls related to the control objectives stated in that description and, in the case of a type 2 report, on the operating effectiveness of those controls, based on the service auditor's procedures.

(h) A statement that the firm of which the practitioner is a member applies HKSQC 1, or other professional requirements, or requirements in law or regulation, that are at least as demanding as HKSQC 1. If the practitioner is not a professional accountant, the statement shall identify the professional requirements, or requirements in law or regulation, applied that are at least as demanding as HKSQC 1.

(i) A statement that the practitioner complies with the independence and other ethical requirements of the Code, or other professional requirements, or requirements imposed by law or regulation, that are at least demanding as Parts A , B and D of the Code related to assurance engagements. If the practitioner is not a professional accountant, the statement shall identify the professional requirements, or requirements imposed by law or regulation, applied that are at least as demanding as Parts A, B and D of the Code related to assurance engagements.

(j) A statement that the engagement was performed in accordance with HKSAE 3402, *Assurance Reports on Controls at a Service Organization*, which requires that the service auditor plan and perform procedures to obtain reasonable assurance about whether, in all material respects, the service organization's description of its system is fairly presented and the controls are suitably designed and, in the case of a type 2 report, are operating effectively.

(k) A summary of the service auditor's procedures to obtain reasonable assurance and a statement of the service auditor's belief that the evidence obtained is sufficient and appropriate to provide a basis for the service auditor's opinion, and, in the case of a type 1 report, a statement that the service auditor has not performed any procedures regarding the operating effectiveness of controls and therefore no opinion is expressed thereon.

(l) A statement of the limitations of controls and, in the case of a type 2 report, of the risk of projecting to future periods any evaluation of the operating effectiveness of controls.

(m) The service auditor's opinion, expressed in the positive form, on whether, in all material respects, based on suitable criteria:

(i) In the case of a type 2 report:

a. The description fairly presents the service organization's system that had been designed and implemented throughout the specified period;

b. The controls related to the control objectives stated in the service organization's description of its system were suitably designed throughout the specified period; and

c. The controls tested, which were those necessary to provide reasonable assurance that the control objectives stated in the description were achieved, operated effectively throughout the specified period.

(ii) In the case of a type 1 report:

a. The description fairly presents the service organization's system that had been designed and implemented as at the specified date; and

b. The controls related to the control objectives stated in the service organization's description of its system were suitably designed as at the specified date.

(n) The date of the service auditor's assurance report, which shall be no earlier than the date on which the service auditor has obtained the evidence on which the service auditor's opinion is based.

(o) The name of the service auditor, and the location in the jurisdiction where the service auditor practices.

54. In the case of a type 2 report, the service auditor's assurance report shall include a separate section after the opinion, or an attachment, that describes the tests of controls that were performed and the results of those tests. In describing the tests of controls, the service auditor shall clearly state which controls were tested, identify whether the items tested represent all or a selection of the items in the population, and indicate the nature of the tests in sufficient detail to enable user auditors to determine the effect of such tests on their risk assessments. If deviations have been identified, the service auditor shall include the extent of testing performed that led to identification of the deviations (including the sample size where sampling has been used), and the number and nature of the deviations noted. The service auditor shall report deviations even if, on the basis of tests performed, the service auditor has concluded that the related control objective was achieved. (Ref: Para. A18 and A49)

Modified Opinions

55. If the service auditor concludes that: (Ref: Para. A50-A52)

(a) The service organization's description does not fairly present, in all material respects, the system as designed and implemented;

(b) The controls related to the control objectives stated in the description were not suitably designed, in all material respects;

(c) In the case of a type 2 report, the controls tested, which were those necessary to provide reasonable assurance that the control objectives stated in the service organization's description of its system were achieved, did not operate effectively, in all material respects; or

(d) The service auditor is unable to obtain sufficient appropriate evidence,

the service auditor's opinion shall be modified, and the service auditor's assurance report shall include a section with a clear description of all the reasons for the modification.

Other Communication Responsibilities

56. If the service auditor becomes aware of non-compliance with laws and regulations, fraud, or uncorrected errors attributable to the service organization that are not clearly trivial and may affect one or more user entities, the service auditor shall determine whether the matter has been communicated appropriately to affected user entities. If the matter has not been so communicated and the service organization is unwilling to do so, the service auditor shall take appropriate action. (Ref: Para. A53)

Conformity and Compliance with International Standards on Assurance Engagements

57. As of May 2010 *(date of issue)*, this HKSAE conforms with International Standard on Assurance Engagements (ISAE) 3402, "Assurance Reports on Controls at a Service Organization". Compliance with the requirements of this HKSAE ensures compliance with ISAE 3402.

58. Additional local explanations are provided in footnotes 19a and 21a.

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Application and Other Explanatory Material

Scope of this HKSAE (Ref: Para. 1 and 3)

A1. Internal control is a process designed to provide reasonable assurance regarding the achievement of objectives related to the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. Controls related to a service organization's operations and compliance objectives may be relevant to a user entity's internal control as it relates to financial reporting. Such controls may pertain to assertions about presentation and disclosure relating to account balances, classes of transactions or disclosures, or may pertain to evidence that the user auditor evaluates or uses in applying auditing procedures. For example, a payroll processing service organization's controls related to the timely remittance of payroll deductions to government authorities may be relevant to a user entity as late remittances could incur interest and penalties that would result in a liability for the user entity. Similarly, a service organization's controls over the acceptability of investment transactions from a regulatory perspective may be considered relevant to a user entity's presentation and disclosure of transactions and account balances in its financial statements. The determination of whether controls at a service organization related to operations and compliance are likely to be relevant to user entities' internal control as it relates to financial reporting is a matter of professional judgment, having regard to the control objectives set by the service organization and the suitability of the criteria.

A2. The service organization may not be able to assert that the system is suitably designed when, for example, the service organization is operating a system that has been designed by a user entity or is stipulated in a contract between a user entity and the service organization. Because of the inextricable link between the suitable design of controls and their operating effectiveness, the absence of a statement with respect to the suitability of design will likely preclude the service auditor from concluding that the controls provide reasonable assurance that the control objectives have been met and thus from opining on the operating effectiveness of controls. As an alternative, the practitioner may choose to accept an agreed-upon procedures engagement to perform tests of controls, or an assurance engagement under HKSAE 3000 (Revised) to conclude on whether, based on tests of controls, the controls have operated as described.

Definitions (Ref: Para. 9(d) and 9(g))

A3. The definition of "controls at the service organization" includes aspects of user entities' information systems maintained by the service organization, and may also include aspects of one or more of the other components of internal control at a service organization. For example, it may include aspects of a service organization's control environment, monitoring, and control activities when they relate to the services provided. It does not, however, include controls at a service organization that are not related to the achievement of the control objectives stated in the service organization's description of its system, for example, controls related to the preparation of the service organization's own financial statements.

A4. When the inclusive method is used, the requirements in this HKSAE also apply to the services provided by the subservice organization, including obtaining agreement regarding the matters in paragraph 13(b)(i)-(vi) as applied to the subservice organization rather than the service organization. Performing procedures at the subservice organization entails coordination and communication between the service organization, the subservice organization, and the service auditor. The inclusive method generally is feasible only if the service organization and the subservice organization are related, or if the contract between the service organization and the subservice organization provides for its use.

Ethical Requirements (Ref: Para. 11)

A5. The service auditor is subject to relevant independence requirements of the Code. In performing an engagement in accordance with this HKSAE, the Code does not require the service auditor to be independent from each user entity.

Management and Those Charged with Governance (Ref: Para. 12)

A6. Management and governance structures vary by jurisdiction and by entity, reflecting influences such as different cultural and legal backgrounds, and size and ownership characteristics. Such diversity means that it is not possible for this HKSAE to specify for all engagements the person(s) with whom the service auditor is to interact regarding particular matters. For example, the service organization may be a segment of a third-party organization and not a separate legal entity. In such cases, identifying the appropriate management personnel or those charged with governance from whom to request written representations may require the exercise of professional judgment.

Acceptance and Continuance

Capabilities and Competence to Perform the Engagement (Ref: Para. 13(a)(i))

A7. Relevant capabilities and competence to perform the engagement include matters such as the following:

- Knowledge of the relevant industry;

- An understanding of information technology and systems;
- Experience in evaluating risks as they relate to the suitable design of controls; and
- Experience in the design and execution of tests of controls and the evaluation of the results.

Service Organization's Statement (Ref: Para. 13(b)(i))

A8. Refusal, by a service organization, to provide a written statement, subsequent to an agreement by the service auditor to accept, or continue, an engagement, represents a scope limitation that causes the service auditor to withdraw from the engagement. If law or regulation does not allow the service auditor to withdraw from the engagement, the service auditor disclaims an opinion.

Reasonable Basis for Service Organization's Statement (Ref: Para. 13(b)(ii))

A9. In the case of a type 2 report, the service organization's statement includes a statement that the controls related to the control objectives stated in the service organization's description of its system operated effectively throughout the specified period. This statement may be based on the service organization's monitoring activities. Monitoring of controls is a process to assess the effectiveness of controls over time. It involves assessing the effectiveness of controls on a timely basis, identifying and reporting deficiencies to appropriate individuals within the service organization, and taking necessary corrective actions. The service organization accomplishes monitoring of controls through ongoing activities, separate evaluations, or a combination of both. The greater the degree and effectiveness of ongoing monitoring activities, the less need for separate evaluations. Ongoing monitoring activities are often built into the normal recurring activities of a service organization and include regular management and supervisory activities. Internal auditors or personnel performing similar functions may contribute to the monitoring of a service organization's activities. Monitoring activities may also include using information communicated by external parties, such as customer complaints and regulator comments, which may indicate problems or highlight areas in need of improvement. The fact that the service auditor will report on the operating effectiveness of controls is not a substitute for the service organization's own processes to provide a reasonable basis for its statement.

Identification of Risks (Ref: Para. 13(b)(v))

A10. As noted in paragraph 9(c), control objectives relate to risks that controls seek to mitigate. For example, the risk that a transaction is recorded at the wrong amount or in the wrong period can be expressed as a control objective that transactions are recorded at the correct amount and in the correct period. The service organization is responsible for identifying the risks that threaten achievement of the control objectives stated in the description of its system. The service organization may have a formal or informal process for identifying relevant risks. A formal process may include estimating the significance of identified risks, assessing the likelihood of their occurrence, and deciding about actions to address them. However, since control objectives relate to risks that controls seek to mitigate, thoughtful identification of control objectives when designing and implementing the service organization's system may itself comprise an informal process for identifying relevant risks.

Acceptance of a Change in the Terms of the Engagement (Ref: Para. 14)

A11. A request to change the scope of the engagement may not have a reasonable justification when, for example, the request is made to exclude certain control objectives from the scope of the engagement because of the likelihood that the service auditor's opinion would be modified; or the service organization will not provide the service auditor with a written statement and the request is made to perform the engagement under HKSAE 3000 (Revised).

A12. A request to change the scope of the engagement may have a reasonable justification when, for example, the request is made to exclude from the engagement a subservice organization when the service organization cannot arrange for access by the service auditor, and the method used for dealing with the services provided by that subservice organization is changed from the inclusive method to the carve-out method.

Assessing the Suitability of the Criteria (Ref: Para. 15-18)

A13. Criteria need to be available to the intended users to allow them to understand the basis for the service organization's statement about the fair presentation of its description of the system, the suitability of the design of controls and, in the case of a type 2 report, the operating effectiveness of the controls related to the control objectives.

A14. HKSAE 3000 (Revised) requires the service auditor, among other things, to determine whether the criteria to be used are suitable, and to determine the appropriateness of the underlying subject matter.[11] The underlying subject matter is the underlying condition of interest to intended users of an assurance report. The following table identifies the subject matter and minimum criteria for each of the opinions in type 2 and type 1 reports.

	Subject matter	**Criteria**	**Comment**
Opinion about the fair presentation of the description of the service organization's system (type 1 and type 2 reports)	The service organization's system that is likely to be relevant to user entities' internal control as it relates to financial reporting and is covered by the service auditor's assurance report.	The description is fairly presented if it: (a) presents how the service organization's system was designed and implemented including, as appropriate, the matters identified in paragraph 16(a)(i)-(viii); (b) in the case of a type 2 report, includes relevant details of changes to the service organization's system during the period covered by the description; and (c) does not omit or distort information relevant to the scope of the service organization's system being described, while	The specific wording of the criteria for this opinion may need to be tailored to be consistent with criteria established by, for example, law or regulation, user groups, or a professional body. Examples of criteria for this opinion are provided in the illustrative service organization's statement in Appendix 1. Paragraphs A21-A24 offer further guidance on determining whether these criteria are met. (In terms of the requirements of HKSAE 3000 (Revised), the subject matter information[12] for this opinion is the service organization's description of its system and the service organization's statement that the description is fairly presented.)

[11] HKSAE 3000 (Revised), paragraphs 24(b) and 41

[12] The "subject matter information" is the outcome of the measurement or evaluation of the underlying subject matter against the criteria, i.e., the information that results from applying the criteria to the underlying subject matter.

	Subject matter	Criteria	Comment	
		acknowledging that the description is prepared to meet the common needs of a broad range of user entities and may not, therefore, include every aspect of the service organization's system that each individual user entity may consider important in its own particular environment.		
Opinion about suitability of design, and operating effectiveness (type 2 reports)	The suitability of the design and operating effectiveness of those controls that are necessary to achieve the control objectives stated in the service organization's description of its system.	The controls are suitably designed and operating effectively if: (a) the service organization has identified the risks that threaten achievement of the control objectives stated in the description of its system; (b) the controls identified in that description would, if operated as described, provide reasonable assurance that those risks do not prevent the stated control objectives from being achieved; and (c) the controls were consistently applied as designed throughout the specified period. This includes whether manual controls were applied by individuals who have the appropriate competence and authority.	When the criteria for this opinion are met, controls will have provided reasonable assurance that the related control objectives were achieved throughout the specified period. (In terms of the requirements of HKSAE 3000 (Revised), the subject matter information for this opinion is the service organization's statement that controls are suitably designed and that they are operating effectively.)	The control objectives, which are stated in the service organization's description of its system, are part of the criteria for these opinions. The stated control objectives will differ from engagement to engagement. If, as part of forming the opinion on the description, the service auditor concludes the stated control objectives are not fairly presented then those control objectives would not be suitable as part of the criteria for forming an opinion on either the design or operating effectiveness of controls.

	Subject matter	Criteria	Comment	
Opinion about suitability of design (type 1 reports)	The suitability of the design of those controls that are necessary to achieve the control objectives stated in the service organization's description of its system.	The controls are suitably designed if: (a) the service organization has identified the risks that threaten achievement of the control objectives stated in the description of its system; and (b) the controls identified in that description would, if operated as described, provide reasonable assurance that those risks do not prevent the stated control objectives from being achieved.	Meeting these criteria does not, of itself, provide any assurance that the related control objectives were achieved because no assurance has been obtained about the operation of controls. (In terms of the requirements of HKSAE 3000 (Revised), the subject matter information for this opinion is the service organization's statement that controls are suitably designed.)	

A15. Paragraph 16(a) identifies a number of elements that are included in the service organization's description of its system as appropriate. These elements may not be appropriate if the system being described is not a system that processes transactions, for example, if the system relates to general controls over the hosting of an IT application but not the controls embedded in the application itself.

Materiality (Ref: Para. 19 and 54)

A16. In an engagement to report on controls at a service organization, the concept of materiality relates to the system being reported on, not the financial statements of user entities. The service auditor plans and performs procedures to determine whether the service organization's description of its system is fairly presented in all material respects, whether controls at the service organization are suitably designed in all material respects and, in the case of a type 2 report, whether controls at the service organization are operating effectively in all material respects. The concept of materiality takes into account that the service auditor's assurance report provides information about the service organization's system to meet the common information needs of a broad range of user entities and their auditors who have an understanding of the manner in which that system has been used.

A17. Materiality with respect to the fair presentation of the service organization's description of its system, and with respect to the design of controls, includes primarily the consideration of qualitative factors, for example: whether the description includes the significant aspects of processing significant transactions; whether the description omits or distorts relevant information; and the ability of controls, as designed, to provide reasonable assurance that control objectives would be achieved. Materiality with respect to the service auditor's opinion on the operating effectiveness of controls includes the consideration of both quantitative and qualitative factors, for example, the tolerable rate and observed rate of deviation (a quantitative matter), and the nature and cause of any observed deviation (a qualitative matter).

A18. The concept of materiality is not applied when disclosing, in the description of the tests of controls, the results of those tests where deviations have been identified. This is because, in the particular circumstances of a specific user entity or user auditor, a deviation may have significance beyond whether or not, in the opinion of the service auditor, it prevents a control from operating effectively. For example, the control to which the deviation relates may be particularly significant in preventing a certain type of error that may be material in the particular circumstances of a user entity's financial statements.

Obtaining an Understanding of the Service Organization's System (Ref: Para. 20)

A19. Obtaining an understanding of the service organization's system, including controls, included in the scope of the engagement, assists the service auditor in:

- Identifying the boundaries of that system, and how it interfaces with other systems.
- Assessing whether the service organization's description fairly presents the system that has been designed and implemented.
- Obtaining an understanding of internal control over the preparation of the service organization's statement.
- Determining which controls are necessary to achieve the control objectives stated in the service organization's description of its system.
- Assessing whether controls were suitably designed.
- Assessing, in the case of a type 2 report, whether controls were operating effectively.

A20. The service auditor's procedures to obtain this understanding may include:

- Inquiring of those within the service organization who, in the service auditor's judgment, may have relevant information.
- Observing operations and inspecting documents, reports, printed and electronic records of transaction processing.
- Inspecting a selection of agreements between the service organization and user entities to identify their common terms.
- Reperforming control procedures.

Obtaining Evidence Regarding the Description (Ref: Para. 21-22)

A21. Considering the following questions may assist the service auditor in determining whether those aspects of the description included in the scope of the engagement are fairly presented in all material respects:

- Does the description address the major aspects of the service provided (within the scope of the engagement) that could reasonably be expected to be relevant to the common needs of a broad range of user auditors in planning their audits of user entities' financial statements?

- Is the description prepared at a level of detail that could reasonably be expected to provide a broad range of user auditors with sufficient information to obtain an understanding of internal control in accordance with HKSA 315 (Revised)?[13] The description need not address every aspect of the service organization's processing or the services provided to user entities, and need not be so detailed as to potentially allow a reader to compromise security or other controls at the service organization.

- Is the description prepared in a manner that does not omit or distort information that may affect the common needs of a broad range of user auditors' decisions, for example, does the description contain any significant omissions or inaccuracies in processing of which the service auditor is aware?

- Where some of the control objectives stated in the service organization's description of its system have been excluded from the scope of the engagement, does the description clearly identify the excluded objectives?

- Have the controls identified in the description been implemented?

- Are complementary user entity controls, if any, described adequately? In most cases, the description of control objectives is worded such that the control objectives are capable of being achieved through effective operation of controls implemented by the service organization alone. In some cases, however, the control objectives stated in the service organization's description of its system cannot be achieved by the service organization alone because their achievement requires particular controls to be implemented by user entities. This may be the case where, for example, the control objectives are specified by a regulatory authority. When the description does include complementary user entity controls, the description separately identifies those controls along with the specific control objectives that cannot be achieved by the service organization alone.

- If the inclusive method has been used, does the description separately identify controls at the service organization and controls at the subservice organization? If the carve-out method is used, does the description identify the functions that are performed by the subservice organization? When the carve-out method is used, the description need not describe the detailed processing or controls at the subservice organization.

A22. The service auditor's procedures to evaluate the fair presentation of the description may include:

- Considering the nature of user entities and how the services provided by the service organization are likely to affect them, for example, whether user entities are from a particular industry and whether they are regulated by government agencies.

- Reading standard contracts, or standard terms of contracts, (if applicable) with user entities to gain an understanding of the service organization's contractual obligations.

- Observing procedures performed by service organization personnel.

- Reviewing the service organization's policy and procedure manuals and other systems

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[13] HKSA 315 (Revised), *Identifying and Assessing Risks of Material Misstatement through Understanding the Entity and Its Environment*

documentation, for example, flowcharts and narratives.

A23. Paragraph 21(a) requires the service auditor to evaluate whether the control objectives stated in the service organization's description of its system are reasonable in the circumstances. Considering the following questions may assist the service auditor in this evaluation:

- Have the stated control objectives been designated by the service organization or by outside parties such as a regulatory authority, a user group, or a professional body that follows a transparent due process?
- Where the stated control objectives have been specified by the service organization, do they relate to the types of assertions commonly embodied in the broad range of user entities' financial statements to which controls at the service organization could reasonably be expected to relate? Although the service auditor ordinarily will not be able to determine how controls at a service organization specifically relate to the assertions embodied in individual user entities' financial statements, the service auditor's understanding of the nature of the service organization's system, including controls, and services being provided is used to identify the types of assertions to which those controls are likely to relate.
- Where the stated control objectives have been specified by the service organization, are they complete? A complete set of control objectives can provide a broad range of user auditors with a framework to assess the effect of controls at the service organization on the assertions commonly embodied in user entities' financial statements.

A24. The service auditor's procedures to determine whether the service organization's system has been implemented may be similar to, and performed in conjunction with, procedures to obtain an understanding of that system. They may also include tracing items through the service organization's system and, in the case of a type 2 report, specific inquiries about changes in controls that were implemented during the period. Changes that are significant to user entities or their auditors are included in the description of the service organization's system.

Obtaining Evidence Regarding Design of Controls (Ref: Para. 23 and 28(b))

A25. From the viewpoint of a *user entity* or a *user auditor*, a control is suitably designed if, individually or in combination with other controls, it would, when complied with satisfactorily, provide reasonable assurance that material misstatements are prevented, or detected and corrected. A *service organization* or a *service auditor*, however, is not aware of the circumstances at individual user entities that would determine whether or not a misstatement resulting from a control deviation is material to those user entities. Therefore, from the viewpoint of a service auditor, a control is suitably designed if, individually or in combination with other controls, it would, when complied with satisfactorily, provide reasonable assurance that control objectives stated in the service organization's description of its system are achieved.

A26. A service auditor may consider using flowcharts, questionnaires, or decision tables to facilitate understanding the design of the controls.

A27. Controls may consist of a number of activities directed at the achievement of a control objective. Consequently, if the service auditor evaluates certain activities as being ineffective in achieving a particular control objective, the existence of other activities may allow the service auditor to conclude that controls related to the control objective are suitably designed.

Obtaining Evidence Regarding Operating Effectiveness of Controls

Assessing Operating Effectiveness (Ref: Para. 24)

A28. From the viewpoint of a *user entity* or a *user auditor*, a control is operating effectively if, individually or in combination with other controls, it provides reasonable assurance that material misstatements, whether due to fraud or error, are prevented, or detected and corrected. A *service organization* or a *service auditor*, however, is not aware of the circumstances at individual user entities that would determine whether a misstatement resulting from a control deviation had occurred and, if so, whether it is material. Therefore, from the viewpoint of a service auditor, a control is operating effectively if, individually or in combination with other controls, it provides reasonable assurance that control objectives stated in the service organization's description of its system are achieved. Similarly, a service organization or a service auditor is not in a position to determine whether any observed control deviation would result in a material misstatement from the viewpoint of an individual user entity.

A29. Obtaining an understanding of controls sufficient to opine on the suitability of their design is not sufficient evidence regarding their operating effectiveness, unless there is some automation that provides for the consistent operation of the controls as they were designed and implemented. For example, obtaining information about the implementation of a manual control at a point in time does not provide evidence about operation of the control at other times. However, because of the inherent consistency of IT processing, performing procedures to determine the design of an automated control, and whether it has been implemented, may serve as evidence of that control's operating effectiveness, depending on the service auditor's assessment and testing of other controls, such as those over program changes.

A30. To be useful to user auditors, a type 2 report ordinarily covers a minimum period of six months. If the period is less than six months, the service auditor may consider it appropriate to describe the reasons for the shorter period in the service auditor's assurance report. Circumstances that may result in a report covering a period of less than six months include when (a) the service auditor is engaged close to the date by which the report on controls is to be issued; (b) the service organization (or a particular system or application) has been in operation for less than six months; or (c) significant changes have been made to the controls and it is not practicable either to wait six months before issuing a report or to issue a report covering the system both before and after the changes.

A31. Certain control procedures may not leave evidence of their operation that can be tested at a later date and, accordingly, the service auditor may find it necessary to test the operating effectiveness of such control procedures at various times throughout the reporting period.

A32. The service auditor provides an opinion on the operating effectiveness of controls throughout each period, therefore, sufficient appropriate evidence about the operation of controls during the current period is required for the service auditor to express that opinion. Knowledge of deviations observed in prior engagements may, however, lead the service auditor to increase the extent of testing during the current period.

Testing of Indirect Controls (Ref: Para. 25(b))

A33. In some circumstances, it may be necessary to obtain evidence supporting the effective operation of indirect controls. For example, when the service auditor decides to test the effectiveness of a review of exception reports detailing sales in excess of authorized credit limits, the review and related follow up is the control that is directly of relevance to the service auditor. Controls over the accuracy of the information in the reports (for example, the general IT controls) are described as "indirect" controls.

A34. Because of the inherent consistency of IT processing, evidence about the implementation of an automated application control, when considered in combination with evidence about the operating effectiveness of the service organization's general controls (in particular, change controls), may also provide substantial evidence about its operating effectiveness.

Means of Selecting Items for Testing (Ref: Para. 25(c) and 27)

A35. The means of selecting items for testing available to the service auditor are:

(a) Selecting all items (100% examination). This may be appropriate for testing controls that are applied infrequently, for example, quarterly, or when evidence regarding application of the control makes 100% examination efficient;

(b) Selecting specific items. This may be appropriate where 100% examination would not be efficient and sampling would not be effective, such as testing controls that are not applied sufficiently frequently to render a large population for sampling, for example, controls that are applied monthly or weekly; and

(c) Sampling. This may be appropriate for testing controls that are applied frequently in a uniform manner and which leave documentary evidence of their application.

A36. While selective examination of specific items will often be an efficient means of obtaining evidence, it does not constitute sampling. The results of procedures applied to items selected in this way cannot be projected to the entire population; accordingly, selective examination of specific items does not provide evidence concerning the remainder of the population. Sampling, on the other hand, is designed to enable conclusions to be drawn about an entire population on the basis of testing a sample drawn from it.

The Work of an Internal Audit Function

Obtaining an Understanding of the Internal Audit Function (Ref: Para. 30)

A37. An internal audit function may be responsible for providing analyses, evaluations, assurances, recommendations, and other information to management and those charged with governance. An internal audit function at a service organization may perform activities related to the service organization's own system of internal control, or activities related to the services and systems, including controls, that the service organization is providing to user entities.

Determining Whether and to What Extent to Use the Work of the Internal Auditors (Ref: Para. 33)

A38. In determining the planned effect of the work of the internal auditors on the nature, timing or extent of the service auditor's procedures, the following factors may suggest the need for different or less extensive procedures than would otherwise be the case:

- The nature and scope of specific work performed, or to be performed, by the internal auditors is quite limited.

- The work of the internal auditors relates to controls that are less significant to the service auditor's conclusions.

- The work performed, or to be performed, by the internal auditors does not require subjective or complex judgments.

Using the Work of the Internal Audit Function (Ref: Para. 34)

A39. The nature, timing and extent of the service auditor's procedures on specific work of the internal auditors will depend on the service auditor's assessment of the significance of that work to the service auditor's conclusions (for example, the significance of the risks that the controls tested seek to mitigate), the evaluation of the internal audit function and the evaluation of the specific work of the internal auditors Such procedures may include:

- Examination of items already examined by the internal auditors;
- Examination of other similar items; and
- Observation of procedures performed by the internal auditors.

Effect on the Service Auditor's Assurance Report (Ref: Para. 36-37)

A40. Irrespective of the degree of autonomy and objectivity of the internal audit function, such function is not independent of the service organization as is required of the service auditor when performing the engagement. The service auditor has sole responsibility for the opinion expressed in the service auditor's assurance report, and that responsibility is not reduced by the service auditor's use of the work of the internal auditors.

A41. The service auditor's description of work performed by the internal audit function may be presented in a number of ways, for example:

- By including introductory material to the description of tests of controls indicating that certain work of the internal audit function was used in performing tests of controls.
- Attribution of individual tests to internal audit.

Written Representations (Ref: Para. 38 and 40)

A42. The written representations required by paragraph 38 are separate from, and in addition to, the service organization's statement, as defined at paragraph 9(o).

A43. If the service organization does not provide the written representations requested in accordance with paragraph 38(c) of this HKSAE, it may be appropriate for the service auditor's opinion to be modified in accordance with paragraph 55(d) of this HKSAE.

Other Information (Ref: Para. 42)

A44. The Code requires that a service auditor not be associated with information where the service auditor believes that the information:

(a) Contains a materially false or misleading statement;

(b) Contains statements or information furnished recklessly; or

(c) Omits or obscures information required to be included where such omission or obscurity would be misleading.[14]

If other information included in a document containing the service organization's description of its system and the service auditor's assurance report contains future-oriented information such

[14] The Code, paragraph 110.2

as recovery or contingency plans, or plans for modifications to the system that will address deviations identified in the service auditor's assurance report, or claims of a promotional nature that cannot be reasonably substantiated, the service auditor may request that information be removed or restated.

A45. If the service organization refuses to remove or restate the other information, further actions that may be appropriate include, for example:

- Requesting the service organization to consult with its legal counsel as to the appropriate course of action.
- Describing the material inconsistency or material misstatement of fact in the assurance report.
- Withholding the assurance report until the matter is resolved.
- Withdrawing from the engagement.

Documentation (Ref: Para. 51)

A46. HKSQC 1 (or professional requirements, or requirements in law or regulation that are at least as demanding as HKSQC 1) requires firms to establish policies and procedures for the timely completion of the assembly of engagement files.[15] An appropriate time limit within which to complete the assembly of the final engagement file is ordinarily not more than 60 days after the date of the service auditor's report.[16]

Preparing the Service Auditor's Assurance Report

Content of the Service Auditor's Assurance Report (Ref: Para. 53)

A47. Illustrative examples of service auditors' assurance reports and related service organizations' statements are contained in Appendices 1 and 2.

Intended Users and Purposes of the Service Auditor's Assurance Report (Ref: Para. 53(e))

A48. The criteria used for engagements to report on controls at a service organization are relevant only for the purposes of providing information about the service organization's system, including controls, to those who have an understanding of how the system has been used for financial reporting by user entities. Accordingly this is stated in the service auditor's assurance report. In addition, the service auditor may consider it appropriate to include wording that specifically restricts distribution of the assurance report other than to intended users, its use by others, or its use for other purposes.

Description of the Tests of Controls (Ref: Para. 54)

A49. In describing the nature of the tests of controls for a type 2 report, it assists readers of the service auditor's assurance report if the service auditor includes:

- The results of all tests where deviations have been identified, even if other controls have been identified that allow the service auditor to conclude that the relevant control objective has been achieved or the control tested has subsequently been removed from the service organization's description of its system.

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[15] HKSQC 1, paragraph 45

[16] HKSQC 1, paragraph A54

- Information about causative factors for identified deviations, to the extent the service auditor has identified such factors.

Modified Opinions (Ref: Para. 55)

A50. Illustrative examples of elements of modified service auditor's assurance reports are contained in Appendix 3.

A51. Even if the service auditor has expressed an adverse opinion or disclaimed an opinion, it may be appropriate to describe in the basis for modification paragraph the reasons for any other matters of which the service auditor is aware that would have required a modification to the opinion, and the effects thereof.

A52. When expressing a disclaimer of opinion because of a scope limitation, it is not ordinarily appropriate to identify the procedures that were performed nor include statements describing the characteristics of a service auditor's engagement; to do so might overshadow the disclaimer of opinion.

Other Communication Responsibilities (Ref: Para. 56)

A53. Appropriate actions to respond to the circumstances identified in paragraph 56, unless prohibited by law or regulation, may include:

- Obtaining legal advice about the consequences of different courses of action.
- Communicating with those charged with governance of the service organization.
- Determining whether to communicate with third parties (e.g., law, regulation or relevant ethical requirements may require the service auditor to report to an appropriate authority outside the entity or the external auditor of the service organization,[17] or establish responsibilities under which such reporting may be appropriate in the circumstances).
- Modifying the service auditor's opinion, or adding an Other Matter paragraph.
- Withdrawing from the engagement.

[17] See, for example, Sections 225.44 to 225.48 of the Code

Appendix 1

(Ref. Para. A47)

Example Service Organization's Statements

The following examples of service organization's statements are for guidance only and are not intended to be exhaustive or applicable to all situations.

Example 1: Type 2 Service Organization's Statement

Statement by the Service Organization

The accompanying description has been prepared for customers who have used *[the type or name of]* system and their auditors who have a sufficient understanding to consider the description, along with other information including information about controls operated by customers themselves, when assessing the risks of material misstatements of customers' financial statements. *[Entity's name]* confirms that:

(a) The accompanying description at pages *[bb-cc]* fairly presents *[the type or name of]* system for processing customers' transactions throughout the period *[date]* to *[date]*. The criteria used in making this statement were that the accompanying description:

(i) Presents how the system was designed and implemented, including:

- The types of services provided, including, as appropriate, classes of transactions processed.
- The procedures, within both information technology and manual systems, by which those transactions were initiated, recorded, processed, corrected as necessary, and transferred to the reports prepared for customers.
- The related accounting records, supporting information and specific accounts that were used to initiate, record, process and report transactions; this includes the correction of incorrect information and how information was transferred to the reports prepared for customers.
- How the system dealt with significant events and conditions, other than transactions.
- The process used to prepare reports for customers.
- Relevant control objectives and controls designed to achieve those objectives.
- Controls that we assumed, in the design of the system, would be implemented by user entities, and which, if necessary to achieve control objectives stated in the accompanying description, are identified in the description along with the specific control objectives that cannot be achieved by ourselves alone.
- Other aspects of our control environment, risk assessment process, information system (including the related business processes) and communication, control activities and monitoring controls that were relevant to processing and reporting customers' transactions.

(ii) Includes relevant details of changes to the service organization's system during the period *[date]* to *[date]*.

(iii) Does not omit or distort information relevant to the scope of the system being described, while acknowledging that the description is prepared to meet the common needs of a broad range of customers and their auditors and may not, therefore, include every aspect of the system that each individual customer may consider important in its own particular environment.

(b) The controls related to the control objectives stated in the accompanying description were suitably designed and operated effectively throughout the period *[date]* to *[date]*. The criteria used in making this statement were that:

(i) The risks that threatened achievement of the control objectives stated in the description were identified;

(ii) The identified controls would, if operated as described, provide reasonable assurance that those risks did not prevent the stated control objectives from being achieved; and

(iii) The controls were consistently applied as designed, including that manual controls were applied by individuals who have the appropriate competence and authority, throughout the period *[date]* to *[date]*.

Example 2: Type 1 Service Organization's Statement

The accompanying description has been prepared for customers who have used *[the type or name of]* system and their auditors who have a sufficient understanding to consider the description, along with other information including information about controls operated by customers themselves, when obtaining an understanding of customers' information systems relevant to financial reporting. *[Entity's name]* confirms that:

(a) The accompanying description at pages *[bb-cc]* fairly presents *[the type or name of]* system for processing customers' transactions as at *[date]*. The criteria used in making this statement were that the accompanying description:

(i) Presents how the system was designed and implemented, including:

- The types of services provided, including, as appropriate, classes of transactions processed.

- The procedures, within both information technology and manual systems, by which those transactions were initiated, recorded, processed, corrected as necessary, and transferred to the reports prepared for customers.

- The related accounting records, supporting information and specific accounts that were used to initiate, record, process and report transactions; this includes the correction of incorrect information and how information is transferred to the reports prepared customers.

- How the system dealt with significant events and conditions, other than transactions.

- The process used to prepare reports for customers.

- Relevant control objectives and controls designed to achieve those objectives.

- Controls that we assumed, in the design of the system, would be implemented by user entities, and which, if necessary to achieve control objectives stated in the accompanying description, are identified in the description along with the specific control objectives that cannot be achieved by ourselves alone.

- Other aspects of our control environment, risk assessment process, information system (including the related business processes) and communication, control activities and monitoring controls that were relevant to processing and reporting customers' transactions.

(ii) Does not omit or distort information relevant to the scope of the system being described, while acknowledging that the description is prepared to meet the common needs of a broad range of customers and their auditors and may not, therefore, include every aspect of the system that each individual customer may consider important in its own particular environment.

(b) The controls related to the control objectives stated in the accompanying description were suitably designed as at *[date]*. The criteria used in making this statement were that:

(i) The risks that threatened achievement of the control objectives stated in the description were identified; and

(ii) The identified controls would, if operated as described, provide reasonable assurance that those risks did not prevent the stated control objectives from being achieved.

Appendix 2

(Ref. Para. A47)

Illustrations of Service Auditor's Assurance Reports

The following examples of reports are for guidance only and are not intended to be exhaustive or applicable to all situations.

Illustration 1: Type 2 Service Auditor's Assurance Report

Independent Service Auditor's Assurance Report on the Description of Controls, their Design and Operating Effectiveness

To: XYZ Service Organization

Scope

We have been engaged to report on XYZ Service Organization's description at pages *[bb-cc]* of its *[type or name of]* system for processing customers' transactions throughout the period *[date]* to *[date]* (the description), and on the design and operation of controls related to the control objectives stated in the description.[18]

XYZ Service Organization's Responsibilities

XYZ Service Organization is responsible for: preparing the description and accompanying statement at page *[aa]*, including the completeness, accuracy and method of presentation of the description and statement; providing the services covered by the description; stating the control objectives; and designing, implementing and effectively operating controls to achieve the stated control objectives.

Our Independence and Quality Control

We have complied with the independence and other ethical requirements of the *Code of Ethics for Professional Accountants* issued by the Hong Kong Institute of Certified Public Accountants, which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

The firm applies Hong Kong Standard on Quality Control 1 [19] and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

Service Auditor's Responsibilities

Our responsibility is to express an opinion on XYZ Service Organization's description and on the design and operation of controls related to the control objectives stated in that description, based on our procedures. We conducted our engagement in accordance with Hong Kong Standard on Assurance Engagements 3402, *Assurance Reports on Controls at a Service Organization*, issued by the Hong Kong Institute of Certified Public Accountants. That standard requires that we plan and

[18] If some elements of the description are not included in the scope of the engagement, this is made clear in the assurance report.

[19] HKSQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

perform our procedures to obtain reasonable assurance about whether, in all material respects, the description is fairly presented and the controls are suitably designed and operating effectively.

An assurance engagement to report on the description, design and operating effectiveness of controls at a service organization involves performing procedures to obtain evidence about the disclosures in the service organization's description of its system, and the design and operating effectiveness of controls. The procedures selected depend on the service auditor's judgment, including the assessment of the risks that the description is not fairly presented, and that controls are not suitably designed or operating effectively. Our procedures included testing the operating effectiveness of those controls that we consider necessary to provide reasonable assurance that the control objectives stated in the description were achieved. An assurance engagement of this type also includes evaluating the overall presentation of the description, the suitability of the control objectives stated therein, and the suitability of the criteria specified by the service organization and described at page *[aa]*.

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

Limitations of Controls at a Service Organization

XYZ Service Organization's description is prepared to meet the common needs of a broad range of customers and their auditors and may not, therefore, include every aspect of the system that each individual customer may consider important in its own particular environment. Also, because of their nature, controls at a service organization may not prevent or detect all errors or omissions in processing or reporting transactions. Also, the projection of any evaluation of effectiveness to future periods is subject to the risk that controls at a service organization may become inadequate or fail.

Opinion

Our opinion has been formed on the basis of the matters outlined in this report. The criteria we used in forming our opinion are those described at page *[aa]*. In our opinion, in all material respects:

(a) The description fairly presents the *[the type or name of]* system as designed and implemented throughout the period from *[date]* to *[date]*;

(b) The controls related to the control objectives stated in the description were suitably designed throughout the period from *[date]* to *[date]*; and

(c) The controls tested, which were those necessary to provide reasonable assurance that the control objectives stated in the description were achieved, operated effectively throughout the period from *[date]* to *[date]*.

Description of Tests of Controls

The specific controls tested and the nature, timing and results of those tests are listed on pages *[yy-zz]*.

Intended Users and Purpose

This report and the description of tests of controls on pages *[yy-zz]* are intended only for customers who have used XYZ Service Organization's *[type or name of]* system, and their auditors, who have a sufficient understanding to consider it, along with other information including information about controls operated by customers themselves, when assessing the risks of material misstatements of customers' financial statements.[19a]

[Service auditor's signature]

[Date of the service auditor's assurance report]

[Service auditor's address]

Illustration 2: Type 1 Service Auditor's Assurance Report

Independent Service Auditor's Assurance Report on the Description of Controls and their Design

To: XYZ Service Organization

Scope

We have been engaged to report on XYZ Service Organization's description at pages *[bb-cc]* of its *[type or name of]* system for processing customers' transactions as at *[date]* (the description), and on the design of controls related to the control objectives stated in the description.[20]

We did not perform any procedures regarding the operating effectiveness of controls included in the description and, accordingly, do not express an opinion thereon.

XYZ Service Organization's Responsibilities

XYZ Service Organization is responsible for: preparing the description and accompanying statement at page *[aa]*, including the completeness, accuracy and method of presentation of the description and the statement; providing the services covered by the description; stating the control objectives; and designing, implementing and effectively operating controls to achieve the stated control objectives.

Our Independence and Quality Control

We have complied with the independence and other ethical requirements of the *Code of Ethics for Professional Accountants* issued by the Hong Kong Institute of Certified Public Accountants, which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

The firm applies Hong Kong Standard on Quality Control 1 [21] and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

[19a] Service 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.

[20] If some elements of the description are not included in the scope of the engagement, this is made clear in the assurance report.

[21] HKSQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

Service Auditor's Responsibilities

Our responsibility is to express an opinion on XYZ Service Organization's description and on the design of controls related to the control objectives stated in that description, based on our procedures. We conducted our engagement in accordance with Hong Kong Standard on Assurance Engagements 3402, *Assurance Reports on Controls at a Service Organization*, issued by the Hong Kong Institute of Certified Public Accountants. That standard requires that we plan and perform our procedures to obtain reasonable assurance about whether, in all material respects, the description is fairly presented and the controls are suitably designed.

An assurance engagement to report on the description and design of controls at a service organization involves performing procedures to obtain evidence about the disclosures in the service organization's description of its system, and the design of controls. The procedures selected depend on the service auditor's judgment, including the assessment that the description is not fairly presented, and that controls are not suitably designed. An assurance engagement of this type also includes evaluating the overall presentation of the description, the suitability of the control objectives stated therein, and the suitability of the criteria specified by the service organization and described at page *[aa]*.

As noted above, we did not perform any procedures regarding the operating effectiveness of controls included in the description and, accordingly, do not express an opinion thereon.

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

Limitations of Controls at a Service Organization

XYZ Service Organization's description is prepared to meet the common needs of a broad range of customers and their auditors and may not, therefore, include every aspect of the system that each individual customer may consider important in its own particular environment. Also, because of their nature, controls at a service organization may not prevent or detect all errors or omissions in processing or reporting transactions.

Opinion

Our opinion has been formed on the basis of the matters outlined in this report. The criteria we used in forming our opinion are those described at page *[aa]*. In our opinion, in all material respects:

(a) The description fairly presents the *[the type or name of]* system as designed and implemented as at *[date]*; and

(b) The controls related to the control objectives stated in the description were suitably designed as at *[date]*.

Intended Users and Purpose

This report is intended only for customers who have used XYZ Service Organization's *[type or name of]* system, and their auditors, who have a sufficient understanding to consider it, along with other information including information about controls operated by customers themselves, when obtaining an understanding of customers' information systems relevant to financial reporting.[21a]

[Service auditor's signature]

[21a] Service 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.

[Date of the service auditor's assurance report]

[Service auditor's address]

Appendix 3

(Ref. Para. A50)

Illustrations of Modified Service Auditor’s Assurance Reports

The following illustrations of modified reports are for guidance only and are not intended to be exhaustive or applicable to all situations. They are based on the illustrations of reports in Appendix 2.

Illustration 1: Qualified opinion – the service organization’s description of the system is not fairly presented in all material respects

…

Service Auditor’s Responsibilities

…

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

Basis for Qualified Opinion

The accompanying description states at page *[mn]* that XYZ Service Organization uses operator identification numbers and passwords to prevent unauthorized access to the system. Based on our procedures, which included inquiries of staff personnel and observation of activities, we have determined that operator identification numbers and passwords are employed in Applications A and B but not in Applications C and D.

Qualified Opinion

Our opinion has been formed on the basis of the matters outlined in this report. The criteria we used in forming our opinion were those described in XYZ Service Organization’s statement at page *[aa]*. In our opinion, except for the matter described in the Basis for Qualified Opinion paragraph:

(a) …

Illustration 2: Qualified opinion – the controls are not suitably designed to provide reasonable assurance that the control objectives stated in the service organization’s description of its system will be achieved if the controls operate effectively

…

Service Auditor’s Responsibilities

…

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

Basis for Qualified Opinion

As discussed at page *[mn]* of the accompanying description, from time to time XYZ Service Organization makes changes in application programs to correct deficiencies or to enhance capabilities. The procedures followed in determining whether to make changes, in designing the changes and in implementing them, do not include review and approval by authorized individuals who are independent from those involved in making the changes. There are also no specified requirements to test such changes or provide test results to an authorized reviewer prior to implementing the changes.

Qualified Opinion

Our opinion has been formed on the basis of the matters outlined in this report. The criteria we used in forming our opinion were those described in XYZ Service Organization's statement at page *[aa]*. In our opinion, except for the matter described in the Basis for Qualified Opinion paragraph:

(a) …

Illustration 3: Qualified opinion – the controls did not operate effectively throughout the specified period (type 2 report only)

…

Service Auditor's Responsibilities

…

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

Basis for Qualified Opinion

XYZ Service Organization states in its description that it has automated controls in place to reconcile loan payments received with the output generated. However, as noted at page *[mn]* of the description, this control was not operating effectively during the period from *dd/mm/yyyy* to *dd/mm/yyyy* due to a programming error. This resulted in the non-achievement of the control objective "Controls provide reasonable assurance that loan payments received are properly recorded" during the period from *dd/mm/yyyy* to *dd/mm/yyyy*. XYZ implemented a change to the program performing the calculation as of *[date]*, and our tests indicate that it was operating effectively during the period from *dd/mm/yyyy* to *dd/mm/yyyy*.

Qualified Opinion

Our opinion has been formed on the basis of the matters outlined in this report. The criteria we used in forming our opinion were those described in XYZ Service Organization's statement at page *[aa]*. In our opinion, except for the matter described in the Basis for Qualified Opinion paragraph:

…

Illustration 4: Qualified opinion – the service auditor is unable to obtain sufficient appropriate evidence

…

Service Auditor's Responsibilities

…

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

Basis for Qualified Opinion

XYZ Service Organization states in its description that it has automated controls in place to reconcile loan payments received with the output generated. However, electronic records of the performance of this reconciliation for the period from *dd/mm/yyyy* to *dd/mm/yyyy* were deleted as a result of a computer processing error, and we were therefore unable to test the operation of this control for that period. Consequently, we were unable to determine whether the control objective "Controls provide reasonable assurance that loan payments received are properly recorded" operated effectively during the period from *dd/mm/yyyy* to *dd/mm/yyyy.*

Qualified Opinion

Our opinion has been formed on the basis of the matters outlined in this report. The criteria we used in forming our opinion were those described in XYZ Service Organization's statement at page *[aa]*. In our opinion, except for the matter described in the Basis for Qualified Opinion paragraph:

(a) …

HKSAE 3410
Issued November 2012, revised March 2014, January 2019

Effective for service auditors' assurance reports
covering periods ending on or after 30 September 2013

Hong Kong Standard on Assurance Engagements 3410

Assurance Engagements on Greenhouse Gas Statements

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

HONG KONG STANDARD ON ASSURANCE ENGAGEMENTS 3410

ASSURANCE ENGAGEMENTS ON GREENHOUSE GAS STATEMENTS

(Effective for assurance reports covering periods ending on or after 30 September 2013)

CONTENTS

Application and Other Explanatory Material

Hong Kong Standard on Assurance Engagements (HKSAE) 3410, *Assurance Engagements on Greenhouse Gas Statements*, should be read in conjunction with the *Preface to the Hong Kong Standards on Quality Control, Auditing, Review, Other Assurance and Related Services Pronouncements*.

Introduction

1. Given the link between greenhouse gas (GHG) emissions and climate change, many entities are quantifying their GHG emissions for internal management purposes, and many are also preparing a GHG statement:

   (a) As part of a regulatory disclosure regime;

   (b) As part of an emissions trading scheme; or

   (c) To inform investors and others on a voluntary basis. Voluntary disclosures may be, for example, published as a stand-alone document; included as part of a broader sustainability report or in an entity's annual report; or made to support inclusion in a "carbon register."

Scope of this HKSAE

2. This Hong Kong Standard on Assurance Engagements (HKSAE) deals with assurance engagements to report on an entity's GHG statement.

3. The practitioner's conclusion in an assurance engagement may cover information in addition to a GHG statement, for example, when the practitioner is engaged to report on a sustainability report of which a GHG statement is only one part. In such cases: (Ref: Para. A1–A2)

   (a) This HKSAE applies to assurance procedures performed with respect to the GHG statement other than when the GHG statement is a relatively minor part of the overall information subject to assurance; and

   (b) HKSAE 3000 (Revised)[1] (or another HKSAE dealing with a specific underlying subject matter) applies to assurance procedures performed with respect to the remainder of the information covered by the practitioner's conclusion.

4. This HKSAE does not deal with, or provide specific guidance for, assurance engagements to report on the following:

   (a) Statements of emissions other than GHG emissions, for example, nitrogen oxides (NOx) and sulfur dioxide (SO_2). This HKSAE may nonetheless provide guidance for such engagements;[2]

   (b) Other GHG-related information, such as product lifecycle "footprints," hypothetical "baseline" information, and key performance indicators based on emissions data; or (Ref: Para. A3)

   (c) Instruments, processes or mechanisms, such as offset projects, used by other entities as emissions deductions. However, where an entity's GHG statement includes emissions deductions that are subject to assurance, the requirements of this HKSAE apply in relation to those emissions deductions as appropriate (see paragraph 76(f)).

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1 HKSAE 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information.*.

2 NOx (i.e., NO and NO_2, which differ from the GHG nitrous oxide, N_2O) and SO_2 are associated with "acid rain" rather than climate change.

Attestation and Direct Engagements

5. The *Hong Kong Framework for Assurance Engagements* (the Assurance Framework) notes that an assurance engagement may be either an attestation engagement or a direct engagement. This HKSAE deals only with attestation engagements.[3]

Procedures for Reasonable Assurance and Limited Assurance Engagements

6. HKSAE 3000 (Revised) notes that an assurance engagement may be either a reasonable assurance engagement or a limited assurance engagement.[4] This HKSAE deals with both reasonable and limited assurance engagements.

7. In both reasonable assurance and limited assurance engagements on a GHG statement, the practitioner chooses a combination of assurance procedures, which can include: inspection; observation; confirmation; recalculation; reperformance; analytical procedures; and inquiry. Determining the assurance procedures to be performed on a particular engagement is a matter of professional judgment. Because GHG statements cover a wide range of circumstances, the nature, timing and extent of procedures are likely to vary considerably from engagement to engagement.

8. Unless otherwise stated, each requirement of this HKSAE applies to both reasonable and limited assurance engagements. Because the level of assurance obtained in a limited assurance engagement is lower than in a reasonable assurance engagement, the procedures the practitioner will perform in a limited assurance engagement will vary in nature and timing from, and are less in extent than for, a reasonable assurance engagement.[5] Requirements that apply to only one or the other type of engagement have been presented in a columnar format with the letter “L” (limited assurance) or “R” (reasonable assurance) after the paragraph number. Although some procedures are required only for reasonable assurance engagements, they may nonetheless be appropriate in some limited assurance engagements (see also paragraph A90, which outlines the primary differences between the practitioner’s further procedures for a reasonable assurance engagement and a limited assurance engagement on a GHG statement). (Ref: Para. A4, A90)

Relationship with HKSAE 3000 (Revised), Other Professional Pronouncements, and Other Requirements

9. *The practitioner is required to comply with HKSAE 3000 (Revised) and this HKSAE when performing an assurance engagement to report on an entity's GHG statement.* This HKSAE supplements, but does not replace, HKSAE 3000 (Revised), and expands on how HKSAE 3000 (Revised) is to be applied in an assurance engagement to report on an entity’s GHG statement. (Ref: Para. A17)

10. Compliance with HKSAE 3000 (Revised) requires, among other things, compliance with Parts A, B and D of the *Code of Ethics for Professional Accountants* issued by the Hong Kong Institute of Certified Public Accountants (the Code) related to assurance engagements, or other professional requirements, or requirements imposed by law or regulation, that are at least as demanding.[6] It also requires the engagement partner to be a member of a firm that

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[3] HKSAE 3000 (Revised), paragraph 12(a)(ii)

[4] HKSAE 3000 (Revised), paragraph 12(a)(i)(b)

[5] HKSAE 3000 (Revised), paragraph 12(a)(iii)

[6] HKSAE 3000 (Revised), paragraphs 3(a), 20 and 34

applies HKSQC 1,[7] or other professional requirements, or requirements in law or regulation, that are at least as demanding as HKSQC 1. (Ref: Para. A5–A6)

11. Where the engagement is subject to local laws or regulations or the provisions of an emissions trading scheme, this HKSAE does not override that law, regulation or provision. In the event that local laws or regulations or the provisions of an emissions trading scheme differ from this HKSAE, an engagement conducted in accordance with local laws or regulations or the provisions of a particular scheme will not automatically comply with this HKSAE. The practitioner is entitled to represent compliance with this HKSAE in addition to compliance with local laws or regulations or the provisions of the emissions trading scheme only when all applicable requirements of this HKSAE have been met. (Ref: Para. A7)

Effective Date

12. This HKSAE is effective for assurance reports covering periods ending on or after 30 September 2013.

Objectives

13. The objectives of the practitioner are:

    (a) To obtain either reasonable assurance or limited assurance, as appropriate, about whether the GHG statement is free from material misstatement, whether due to fraud or error, thereby enabling the practitioner to express a reasonable assurance or limited assurance conclusion;

    (b) To report, in accordance with the practitioner's findings, about whether:

        (i) In the case of a reasonable assurance engagement, the GHG statement is prepared, in all material respects, in accordance with the applicable criteria; or

        (ii) In the case of a limited assurance engagement, anything has come to the practitioner's attention that causes the practitioner to believe, on the basis of the procedures performed and evidence obtained, that the GHG statement is not prepared, in all material respects, in accordance with the applicable criteria; and

    (c) To communicate as otherwise required by this HKSAE, in accordance with the practitioner's findings.

Definitions

14. For purposes of this HKSAE, the following terms have the meanings attributed below:[8]

    (a) Applicable criteria – The criteria used by the entity to quantify and report its emissions in the GHG statement.

    (b) Assertions – Representations by the entity, explicit or otherwise, that are embodied in the the GHG statement, as used by the practitioner to consider the different types of potential misstatements that may occur.

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7 HKSAE 3000 (Revised), paragraphs 3(b) and 31(a). Hong Kong Standard on Quality Control (HKSQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

8 The definitions in HKSAE 3000 (Revised) also apply to this HKSAE.

(c) Base year – A specific year or an average over multiple years against which an entity's emissions are compared over time.

(d) Cap and trade – A system that sets overall emissions limits, allocates emissions allowances to participants, and allows them to trade allowances and emission credits with each other.

(e) Comparative information – The amounts and disclosures included in the GHG statement in respect of one or more prior periods.

(f) Emissions – The GHGs that, during the relevant period, have been emitted to the atmosphere or would have been emitted to the atmosphere had they not been captured and channeled to a sink. Emissions can be categorized as:

- Direct emissions (also known as Scope 1 emissions), which are emissions from sources that are owned or controlled by the entity. (Ref: Para. A8)
- Indirect emissions, which are emissions that are a consequence of the activities of the entity, but which occur at sources that are owned or controlled by another entity. Indirect emissions can be further categorized as:
    - Scope 2 emissions, which are emissions associated with energy that is transferred to and consumed by the entity. (Ref: Para. A9)
    - Scope 3 emissions, which are all other indirect emissions. (Ref: Para. A10)

(g) Emissions deduction – Any item included in the entity's GHG statement that is deducted from the total reported emissions, but which is not a removal; it commonly includes purchased offsets, but can also include a variety of other instruments or mechanisms such as performance credits and allowances that are recognized by a regulatory or other scheme of which the entity is a part. (Ref: Para. A11–A12)

(h) Emissions factor – A mathematical factor or ratio for converting the measure of an activity (for example, liters of fuel consumed, kilometers travelled, the number of animals in husbandry, or tonnes of product produced) into an estimate of the quantity of GHGs associated with that activity.

(i) Emissions trading scheme – A market-based approach used to control greenhouse gases by providing economic incentives for achieving reductions in the emissions of such gases.

(j) Entity – The legal entity, economic entity, or the identifiable portion of a legal or economic entity (for example, a single factory or other form of facility, such as a land fill site), or combination of legal or other entities or portions of those entities (for example, a joint venture) to which the emissions in the GHG statement relate.

(k) Fraud – An intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.

(l) Further procedures – Procedures performed in response to assessed risks of material misstatement, including tests of controls (if any), tests of details and analytical procedures.

(m) GHG statement – A statement setting out constituent elements and quantifying an entity's GHG emissions for a period (sometimes known as an emissions inventory) and, where applicable, comparative information and explanatory notes including a summary of significant quantification and reporting policies. An entity's GHG statement may also include a categorized listing of removals or emissions deductions. Where the engagement does not cover the entire GHG statement, the term "GHG statement" is to be read as that portion that is covered by the engagement. The GHG statement is the "subject matter information" of the engagement.[9]

(n) Greenhouse gases (GHGs) – Carbon dioxide (CO_2) and any other gases required by the applicable criteria to be included in the GHG statement, such as: methane; nitrous oxide; sulfur hexafluoride; hydrofluorocarbons; perfluorocarbons; and chlorofluorocarbons. Gases other than carbon dioxide are often expressed in terms of carbon dioxide equivalents (CO_2-e).

(o) Organizational boundary – The boundary that determines which operations to include in the entity's GHG statement.

(p) Performance materiality – The amount or amounts set by the practitioner at less than materiality for the GHG statement to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the GHG statement. If applicable, performance materiality also refers to the amount or amounts set by the practitioner at less than the materiality level or levels for particular types of emissions or disclosures.

(q) Purchased offset – An emissions deduction in which the entity pays for the lowering of another entity's emissions (emissions reductions) or the increasing of another entity's removals (removal enhancements), compared to a hypothetical baseline. (Ref: Para. A13)

(r) Quantification – The process of determining the quantity of GHGs that relate to the entity, either directly or indirectly, as emitted (or removed) by particular sources (or sinks).

(s) Removal – The GHGs that the entity has, during the period, removed from the atmosphere, or that would have been emitted to the atmosphere had they not been captured and channeled to a sink. (Ref: Para. A14)

(t) Significant facility – A facility that is of individual significance due to the size of its emissions relative to the aggregate emissions included in the GHG statement or its specific nature or circumstances which give rise to particular risks of material misstatement. (Ref: Para. A15–A16)

(u) Sink – A physical unit or process that removes GHGs from the atmosphere.

(v) Source – A physical unit or process that releases GHGs into the atmosphere.

(w) Type of emission – A grouping of emissions based on, for example, source of emission, type of gas, region, or facility.

Requirements

HKSAE 3000 (Revised)

15. The practitioner shall not represent compliance with this HKSAE unless the practitioner has complied with the requirements of both this HKSAE and HKSAE 3000 (Revised). (Ref: Para. A5–A6, A17, A21–A22, A37, A127)

[9] HKSAE 3000 (Revised), paragraph 12(x)

Acceptance and Continuance of the Engagement

Skills, Knowledge and Experience

16. The engagement partner shall:

    (a) Have competence in assurance skills and techniques developed through extensive training and practical application, and sufficient competence in the quantification and reporting of emissions, to accept responsibility for the assurance conclusion; and

    (b) Be satisfied that those persons who are to perform the engagement collectively have the appropriate competence and capabilities, including in the quantification and reporting of emissions and in assurance, to perform the assurance engagement in accordance with this HKSAE. (Ref: Para. A18–A19)

Preconditions for the Engagement

17. In order to establish whether the preconditions for the engagement are present:

    (a) The engagement partner shall determine that both the GHG statement and the engagement have sufficient scope to be useful to intended users, considering, in particular: (Ref: Para. A20)

        (i) If the GHG statement is to exclude significant emissions that have been, or could readily be, quantified, whether such exclusions are reasonable in the circumstances;

        (ii) If the engagement is to exclude assurance with respect to significant emissions that are reported by the entity, whether such exclusions are reasonable in the circumstances; and

        (iii) If the engagement is to include assurance with respect to emissions deductions, whether the nature of the assurance the practitioner will obtain with respect to the deductions and the intended content of the assurance report with respect to them are clear, reasonable in the circumstances, and understood by the engaging party. (Ref: Para. A11-A12)

    (b) When determining the suitability of the applicable criteria, as required by HKSAE 3000 (Revised),[10] the practitioner shall determine whether the criteria encompass at a minimum: (Ref: Para. A23–A26)

        (i) The method for determining the entity's organizational boundary; (Ref: Para. A27–A28)

        (ii) The GHGs to be accounted for;

        (iii) Acceptable quantification methods, including methods for making adjustments to the base year (if applicable); and

        (iv) Adequate disclosures such that intended users can understand the significant judgments made in preparing the GHG statement. (Ref: Para. A29–A34)

[10] HKSAE 3000 (Revised), paragraph 24(b)(ii) and 41

(c) The practitioner shall obtain the agreement of the entity that it acknowledges and understands its responsibility:

(i) For designing, implementing and maintaining such internal control as the entity determines is necessary to enable the preparation of a GHG statement that is free from material misstatement, whether due to fraud or error;

(ii) For the preparation of its GHG statement in accordance with the applicable criteria; and (Ref: Para. A35)

(iii) For referring to or describing in its GHG statement the applicable criteria it has used and, when it is not readily apparent from the engagement circumstances, who developed them. (Ref: Para. A36)

Agreement on the Terms of the Engagement

18. The terms of the engagement required to be agreed by HKSAE 3000 (Revised)[11] shall include: (Ref: Para. A37)

(a) The objective and scope of the engagement;

(b) The responsibilities of the practitioner;

(c) The responsibilities of the entity, including those described in paragraph 17(c);

(d) Identification of the applicable criteria for the preparation of the GHG statement;

(e) Reference to the expected form and content of any reports to be issued by the practitioner and a statement that there may be circumstances in which a report may differ from its expected form and content; and

(f) An acknowledgement that the entity agrees to provide written representations at the conclusion of the engagement.

Planning

19. When planning the engagement as required by HKSAE 3000 (Revised),[12] the practitioner shall: (Ref: Para. A38–A41)

(a) Identify the characteristics of the engagement that define its scope;

(b) Ascertain the reporting objectives of the engagement to plan the timing of the engagement and the nature of the communications required;

(c) Consider the factors that, in the practitioner’s professional judgment, are significant in directing the engagement team’s efforts;

(d) Consider the results of engagement acceptance or continuance procedures and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant;

[11] HKSAE 3000 (Revised), paragraph 27

[12] HKSAE 3000 (Revised), paragraph 40

(e) Ascertain the nature, timing and extent of resources necessary to perform the engagement, including the involvement of experts and of other practitioners; and (Ref: Para. A42– A43)

(f) Determine the impact of the entity's internal audit function, if any, on the engagement.

Materiality in Planning and Performing the Engagement

Determining Materiality and Performance Materiality When Planning the Engagement

20. When establishing the overall engagement strategy, the practitioner shall determine materiality for the GHG statement. (Ref: Para. A44–A50)

21. The practitioner shall determine performance materiality for purposes of assessing the risks of material misstatement and determining the nature, timing and extent of further procedures.

Revision as the Engagement Progresses

22. The practitioner shall revise materiality for the GHG statement in the event of becoming aware of information during the engagement that would have caused the practitioner to have determined a different amount initially. (Ref: Para. A51)

Understanding the Entity and Its Environment, Including the Entity's Internal Control, and Identifying and Assessing the Risks of Material Misstatement

Obtaining an Understanding of the Entity and Its Environment

23. The practitioner shall obtain an understanding of the following: (Ref: Para. A52–A53)

(a) Relevant industry, regulatory, and other external factors including the applicable criteria.

(b) The nature of the entity, including:

(i) The nature of the operations included in the entity's organizational boundary, including: (Ref: Para. A27–A28)

(a) The sources and completeness of emissions and, if any, sinks and emissions deductions;

(b) The contribution of each to the entity's overall emissions; and

(c) The uncertainties associated with the quantities reported in the GHG statement. (Ref: Para. A54–A59)

(ii) Changes from the prior period in the nature or extent of operations, including whether there have been any mergers, acquisitions, or sales of emissions sources, or outsourcing of functions with significant emissions; and

(iii) The frequency and nature of interruptions to operations. (Ref: Para. A60)

(c) The entity's selection and application of quantification methods and reporting policies, including the reasons for changes thereto and the potential for double-counting of emissions in the GHG statement.

(d) The requirements of the applicable criteria relevant to estimates, including related disclosures.

(e) The entity's climate change objective and strategy, if any, and associated economic, regulatory, physical and reputational risks. (Ref: Para. A61)

(f) The oversight of, and responsibility for, emissions information within the entity.

(g) Whether the entity has an internal audit function and, if so, its activities and main findings with respect to emissions.

Procedures to Obtain an Understanding and to Identify and Assess Risks of Material Misstatement

24. The procedures to obtain an understanding of the entity and its environment and to identify and assess risks of material misstatement shall include the following: (Ref: Para. A52–A53, A62)

(a) Inquiries of those within the entity who, in the practitioner's judgment, have information that is likely to assist in identifying and assessing risks of material misstatement due to fraud or error.

(b) Analytical procedures. (Ref: Para. A63–A65)

(c) Observation and inspection. (Ref: Para. A66–A68)

Obtaining an Understanding of the Entity's Internal Control

Limited Assurance	**Reasonable Assurance**
25L. For internal control relevant to emissions quantification and reporting, as the basis for identifying and assessing the risks of material misstatement, the practitioner shall obtain an understanding, through inquiries, about: (Ref: Para. A52–A53, A69–A70) (a) The control environment; (b) The information system, including the related business processes, and communication of emissions reporting roles and responsibilities and significant matters relating to emissions reporting; and (c) The results of the entity's risk assessment process.	25R. The practitioner shall obtain an understanding of the following components of the entity's internal control relevant to emissions quantification and reporting as the basis for identifying and assessing risks of material misstatement: (Ref: Para. A52–A53, A70) (a) The control environment; (b) The information system, including the related business processes, and communication of emissions reporting roles and responsibilities and significant matters relating to emissions reporting; (c) The entity's risk assessment process; (d) Control activities relevant to the engagement, being those the practitioner judges it necessary to understand in order to assess the risks of material misstatement at the assertion level and design further procedures responsive to assessed risks. An assurance engagement

Limited Assurance	Reasonable Assurance
	does not require an understanding of all the control activities related to each significant type of emission and disclosure in the GHG statement or to every assertion relevant to them; and (Ref: Para. A71–A72) (e) Monitoring of controls.
	26R. When obtaining the understanding required by paragraph 25R, the practitioner shall evaluate the design of controls and determine whether they have been implemented by performing procedures in addition to inquiry of the entity's personnel responsible for the GHG statement. (Ref: Para. A52–A53)

Other Procedures to Obtain an Understanding and to Identify and Assess Risks of Material Misstatement

27. If the engagement partner has performed other engagements for the entity, the engagement partner shall consider whether information obtained is relevant to identifying and assessing risks of material misstatement. (Ref: Para. A73)

28. The practitioner shall make inquiries of management, and others within the entity as appropriate, to determine whether they have knowledge of any actual, suspected or alleged fraud or non-compliance with law or regulation affecting the GHG statement. (Ref: Para. A84–A86)

29. The engagement partner and other key members of the engagement team, and any key practitioner's external experts, shall discuss the susceptibility of the entity's GHG statement to material misstatement whether due to fraud or error, and the application of the applicable criteria to the entity's facts and circumstances. The engagement partner shall determine which matters are to be communicated to members of the engagement team, and to any practitioner's external experts not involved in the discussion.

30. The practitioner shall evaluate whether the entity's quantification methods and reporting policies, including the determination of the entity's organizational boundary, are appropriate for its operations, and are consistent with the applicable criteria and quantification and reporting policies used in the relevant industry and in prior periods.

Performing Procedures on Location at the Entity's Facilities

31. The practitioner shall determine whether it is necessary in the circumstances of the engagement to perform procedures on location at significant facilities. (Ref: Para. A15–A16, A74–A77)

Internal Audit

32. Where the entity has an internal audit function that is relevant to the engagement, the practitioner shall: (Ref: Para. A78)

    (a) Determine whether, and to what extent, to use specific work of the internal audit function; and

    (b) If using the specific work of the internal audit function, determine whether that work is adequate for the purposes of the engagement.

Identifying and Assessing Risks of Material Misstatement

Limited Assurance	Reasonable Assurance
33L. The practitioner shall identify and assess risks of material misstatement: (a) At the GHG statement level; and (Ref: Para. A79–A80) (b) For material types of emissions and disclosures, (Ref: Para. A81) as the basis for designing and performing procedures whose nature, timing and extent: (c) Are responsive to assessed risks of material misstatement; and (d) Allow the practitioner to obtain limited assurance about whether the GHG statement is prepared, in all material respects, in accordance with the applicable criteria.	33R. The practitioner shall identify and assess risks of material misstatement: (a) At the GHG statement level; and (Ref: Para. A79–A80) (b) At the assertion level for material types of emissions and disclosures, (Ref: Para. A81–A82) as the basis for designing and performing procedures whose nature, timing and extent: (Ref: Para. A83) (c) Are responsive to assessed risks of material misstatement; and (d) Allow the practitioner to obtain reasonable assurance about whether the GHG statement is prepared, in all material respects, in accordance with the applicable criteria.

Causes of Risks of Material Misstatement

34. When performing the procedures required by paragraphs 33L or 33R, the practitioner shall consider at least the following factors: (Ref: Para. A84–A89)

    (a) The likelihood of intentional misstatement in the GHG statement; (Ref: Para. A84–A86)

    (b) The likelihood of non-compliance with the provisions of those laws and regulations generally recognized to have a direct effect on the content of the GHG statement; (Ref: Para. A87)

    (c) The likelihood of omission of a potentially significant emission; (Ref: Para. A88(a))

    (d) Significant economic or regulatory changes; (Ref: Para. A88(b))

    (e) The nature of operations; (Ref: Para. A88(c))

(f) The nature of quantification methods; (Ref: Para. A88(d))

(g) The degree of complexity in determining the organizational boundary and whether related parties are involved; (Ref: Para. A27–A28)

(h) Whether there are significant emissions that are outside the normal course of business for the entity, or that otherwise appear to be unusual; (Ref: Para. A88(e))

(i) The degree of subjectivity in the quantification of emissions; (Ref: Para. A88(e))

(j) Whether Scope 3 emissions are included in the GHG statement; and (Ref: Para. A88(f))

(k) How the entity makes significant estimates and the data on which they are based. (Ref: Para. A88(g))

Overall Responses to Assessed Risks of Material Misstatement and Further Procedures

35. The practitioner shall design and implement overall responses to address the assessed risks of material misstatement at the GHG statement level. (Ref: Para. A90–A93)

36. The practitioner shall design and perform further procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement, having regard to the level of assurance, reasonable or limited, as appropriate. (Ref: Para. A90)

Limited Assurance	**Reasonable Assurance**
37L. In designing and performing the further procedures in accordance with paragraph 36, the practitioner shall: (Ref: Para. A90, A94) (a) Consider the reasons for the assessment given to the risks of material misstatement for material types of emissions and disclosures; and (Ref: Para. A95) (b) Obtain more persuasive evidence the higher the practitioner's assessment of risk. (Ref: Para. A97)	37R. In designing and performing the further procedures in accordance with paragraph 36, the practitioner shall: (Ref: Para. A90, A94) (a) Consider the reasons for the assessment given to the risks of material misstatement at the assertion level for material types of emissions and disclosures, including: (Ref: Para. A95) (i) The likelihood of material misstatement due to the particular characteristics of the relevant type of emission or disclosure (that is, the inherent risk); and (ii) Whether the practitioner intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of other procedures; and (Ref: Para. A96) (b) Obtain more persuasive evidence the higher the practitioner's assessment of risk. (Ref: Para. A97)

Limited Assurance	Reasonable Assurance
	Tests of Controls 38R. The practitioner shall design and perform tests of controls to obtain sufficient appropriate evidence as to the operating effectiveness of relevant controls if: (Ref: Para. A90(a)) (a) The practitioner intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of other procedures; or (Ref: Para. A96) (b) Procedures other than tests of controls cannot alone provide sufficient appropriate evidence at the assertion level. (Ref: Para. A98) 39R. If deviations from controls upon which the practitioner intends to rely are detected, the practitioner shall make specific inquiries to understand these matters and their potential consequences, and shall determine whether: (Ref: Para. A90) (a) The tests of controls that have been performed provide an appropriate basis for reliance on the controls; (b) Additional tests of controls are necessary; or (c) The potential risks of material misstatement need to be addressed using other procedures. *Procedures Other than Tests of Controls* 40R. Irrespective of the assessed risks of material misstatement, the practitioner shall design and perform tests of details or analytical procedures in addition to tests of controls, if any, for each material type of emission and disclosure. (Ref: Para. A90, A94) 41R. The practitioner shall consider whether external confirmation procedures are to be performed. (Ref: Para.A90, A99)

Limited Assurance	Reasonable Assurance
Analytical Procedures Performed in Response to Assessed Risks of Material Misstatement	*Analytical Procedures Performed in Response to Assessed Risks of Material Misstatement*
42L. If designing and performing analytical procedures, the practitioner shall: (Ref: Para. A90(c), A100–A102) (a) Determine the suitability of particular analytical procedures, taking account of the assessed risks of material misstatement and tests of details, if any; (b) Evaluate the reliability of data from which the practitioner's expectation of recorded quantities or ratios is developed, taking account of the source, comparability, and nature and relevance of information available, and controls over preparation; and (c) Develop an expectation with respect to recorded quantities or ratios.	42R. If designing and performing analytical procedures, the practitioner shall: (Ref: Para. A90(c), A100–A102) (a) Determine the suitability of particular analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions; (b) Evaluate the reliability of data from which the practitioner's expectation of recorded quantities or ratios is developed, taking account of the source, comparability, and nature and relevance of information available, and controls over preparation; and (c) Develop an expectation of recorded quantities or ratios which is sufficiently precise to identify possible material misstatements.
43L. If analytical procedures identify fluctuations or relationships that are inconsistent with other relevant information or that differ significantly from expected quantities or ratios, the practitioner shall make inquiries of the entity about such differences. The practitioner shall consider the responses to these inquiries to determine whether other procedures are necessary in the circumstances. (Ref: Para. A90(c))	43R. If analytical procedures identify fluctuations or relationships that are inconsistent with other relevant information or that differ significantly from expected quantities or ratios, the practitioner shall investigate such differences by: (Ref: Para. A90(c)) (a) Inquiring of the entity and obtaining additional evidence relevant to the entity's responses; and (b) Performing other procedures as necessary in the circumstances.
Procedures Regarding Estimates	*Procedures Regarding Estimates*
44L. Based on the assessed risks of material misstatement, the practitioner shall: (Ref: Para. A103–A104) (a) Evaluate whether: (i) The entity has appropriately applied the requirements of the applicable criteria relevant	44R. Based on the assessed risks of material misstatement, the practitioner shall evaluate whether: (Ref: Para. A103) (a) The entity has appropriately applied the requirements of the applicable criteria relevant to estimates; and (b) The methods for making estimates

Limited Assurance	Reasonable Assurance
to estimates; and (ii) The methods for making estimates are appropriate and have been applied consistently, and whether changes, if any, in reported estimates or in the method for making them from the prior period are appropriate in the circumstances; and (b) Consider whether other procedures are necessary in the circumstances.	are appropriate and have been applied consistently, and whether changes, if any, in reported estimates or in the method for making them from the prior period are appropriate in the circumstances. 45R. In responding to an assessed risk of material misstatement, the practitioner shall undertake one or more of the following, taking account of the nature of estimates: (Ref: Para. A103) (a) Test how the entity made the estimate and the data on which it is based. In doing so, the practitioner shall evaluate whether: (i) The method of quantification used is appropriate in the circumstances; and (ii) The assumptions used by the entity are reasonable. (b) Test the operating effectiveness of the controls over how the entity made the estimate, together with other appropriate procedures. (c) Develop a point estimate or a range to evaluate the entity's estimate. For this purpose: (i) If the practitioner uses assumptions or methods that differ from the entity's, the practitioner shall obtain an understanding of the entity's assumptions or methods sufficient to establish that the practitioner's point estimate or range takes into account relevant variables and to evaluate any significant differences from the entity's point estimate. (ii) If the practitioner concludes that it is appropriate to use a range, the practitioner shall narrow the range, based on evidence available, until all outcomes within the range

Limited Assurance	Reasonable Assurance
	are considered reasonable.

Sampling

46. If sampling is used, the practitioner shall, when designing the sample, consider the purpose of the procedure and the characteristics of the population from which the sample will be drawn. (Ref: Para. A90(b), A105)

Fraud, Laws and Regulations

47. The practitioner shall respond appropriately to fraud or suspected fraud and non-compliance or suspected non-compliance with law or regulation identified during the engagement. (Ref: Para. A106–A107)

Limited Assurance	Reasonable Assurance
Procedures Regarding the GHG Statement Aggregation Process	*Procedures Regarding the GHG Statement Aggregation Process*
48L. The practitioner's procedures shall include the following procedures related to the GHG statement aggregation process: (Ref: Para. A108)	48R. The practitioner's procedures shall include the following procedures related to the GHG statement aggregation process: (Ref: Para. A108)
(a) Agreeing or reconciling the GHG statement with the underlying records; and	(a) Agreeing or reconciling the GHG statement with the underlying records; and
(b) Obtaining, through inquiry of the entity, an understanding of material adjustments made during the course of preparing the GHG statement and considering whether other procedures are necessary in the circumstances.	(b) Examining material adjustments made during the course of preparing the GHG statement.

Determining Whether Additional Procedures Are Necessary in a Limited Assurance Engagement	*Revision of Risk Assessment in a Reasonable Assurance Engagement*
49L. If the practitioner becomes aware of a matter(s) that causes the practitioner to believe the GHG statement may be materially misstated, the practitioner shall design and perform additional procedures to obtain further evidence until the practitioner is able to: (Ref: Para. A109–A110) (a) Conclude that the matter(s) is not likely to cause the GHG statement to be materially misstated; or (b) Determine that the matter(s) causes the GHG statement to be materially misstated. (Ref: Para. A111)	49R. The practitioner's assessment of the risks of material misstatement at the assertion level may change during the course of the engagement as additional evidence is obtained. In circumstances where the practitioner obtains evidence which is inconsistent with the evidence on which the practitioner originally based the assessment, the practitioner shall revise the assessment and modify the planned procedures accordingly. (Ref: Para. A109)

Accumulation of Identified Misstatements

50. The practitioner shall accumulate misstatements identified during the engagement, other than those that are clearly trivial. (Ref: Para. A112)

Consideration of Identified Misstatements as the Engagement Progresses

51. The practitioner shall determine whether the overall engagement strategy and engagement plan need to be revised if:

    (a) The nature of identified misstatements and the circumstances of their occurrence indicate that other misstatements may exist that, when aggregated with misstatements accumulated during the engagement, could be material; or

    (b) The aggregate of misstatements accumulated during the engagement approaches materiality determined in accordance with paragraphs 20–22 of this HKSAE.

52. If, at the practitioner's request, the entity has examined a type of emission or disclosure and corrected misstatements that were detected, the practitioner shall perform procedures with respect to the work performed by the entity to determine whether material misstatements remain.

Communication and Correction of Misstatements

53. The practitioner shall communicate on a timely basis all misstatements accumulated during the engagement with the appropriate level within the entity and shall request the entity to correct those misstatements.

54. If the entity refuses to correct some or all of the misstatements communicated by the practitioner, the practitioner shall obtain an understanding of the entity's reasons for not making the corrections and shall take that understanding into account when forming the practitioner's conclusion.

Evaluating the Effect of Uncorrected Misstatements

55. Prior to evaluating the effect of uncorrected misstatements, the practitioner shall reassess materiality determined in accordance with paragraphs 20–22 of this HKSAE to confirm whether it remains appropriate in the context of the entity's actual emissions.

56. The practitioner shall determine whether uncorrected misstatements are material, individually or in the aggregate. In making this determination, the practitioner shall consider the size and nature of the misstatements, and the particular circumstances of their occurrence, in relation to particular types of emissions or disclosures and the GHG statement (see paragraph 72).

Using the Work of Another Practitioners

57. When the practitioner intends to use the work of another practitioners, the practitioner shall:

    (a) Communicate clearly with the other practitioners about the scope and timing of the work and findings of the other practitioner; and (Ref: Para. A113–A114)

    (b) Evaluate the sufficiency and appropriateness of evidence obtained and the process for including related information in the GHG statement. (Ref: Para. A115)

Written Representations

58. The practitioner shall request written representations from a person(s) within the entity with appropriate responsibilities for, and knowledge of, the matters concerned: (Ref: Para. A116)

    (a) That they have fulfilled their responsibility for the preparation of the GHG statement, including comparative information where appropriate, in accordance with the applicable criteria, as set out in the terms of the engagement;

    (b) That they have provided the practitioner with all relevant information and access as agreed in the terms of the engagement and reflected all relevant matters in the GHG statement;

    (c) Whether they believe the effects of uncorrected misstatements are immaterial, individually and in the aggregate, to the GHG statement. A summary of such items shall be included in, or attached to, the written representation;

    (d) Whether they believe that significant assumptions used in making estimates are reasonable;

    (e) That they have communicated to the practitioner all deficiencies in internal control relevant to the engagement that are not clearly trivial of which they are aware; and

    (f) Whether they have disclosed to the practitioner their knowledge of actual, suspected or alleged fraud or non-compliance with law or regulation where the fraud or non-compliance could have a material effect on the GHG statement.

59. The date of the written representations shall be as near as practicable to, but not after, the date of the assurance report.

60. The practitioner shall disclaim a conclusion on the GHG statement or withdraw from the engagement, where withdrawal is possible under applicable law or regulation, if:

    (a) The practitioner concludes that there is sufficient doubt about the integrity of the person(s) providing the written representations required by paragraphs 58(a) and (b) that written representations in these regards are not reliable; or

(b) The entity does not provide the written representations required by paragraphs 58(a) and (b).

Subsequent Events

61. The practitioner shall: (Ref: Para. A117)

(a) Consider whether events occurring between the date of the GHG statement and the date of the assurance report require adjustment of, or disclosure in, the GHG statement, and evaluate the sufficiency and appropriateness of evidence obtained about whether such events are appropriately reflected in that GHG statement in accordance with the applicable criteria; and

(b) Respond appropriately to facts that become known to the practitioner after the date of the assurance report, that, had they been known to the practitioner at that date, may have caused the practitioner to amend the assurance report.

Comparative Information

62. When comparative information is presented with the current emissions information and some or all of that comparative information is covered by the practitioner's conclusion, the practitioner's procedures with respect to the comparative information shall include evaluating whether: (Ref: Para. A118–A121)

(a) The comparative information agrees with the amounts and other disclosures presented in the prior period or, when appropriate, has been properly restated and that restatement has been adequately disclosed; and (Ref Para. A121)

(b) The quantification policies reflected in the comparative information are consistent with those applied in the current period or, if there have been changes, whether they have been properly applied and adequately disclosed.

63. Irrespective of whether the practitioner's conclusion covers the comparative information, if the practitioner becomes aware that there may be a material misstatement in the comparative information presented the practitioner shall:

(a) Discuss the matter with those person(s) within the entity with appropriate responsibilities for, and knowledge of, the matters concerned and perform procedures appropriate in the circumstances; and (Ref: Para. A122–A123)

(b) Consider the effect on the assurance report. If the comparative information presented contains a material misstatement, and the comparative information has not been restated:

(i) Where the practitioner's conclusion covers the comparative information, the practitioner shall express a qualified conclusion or an adverse conclusion in the assurance report; or

(ii) Where the practitioner's conclusion does not cover the comparative information, the practitioner shall include an Other Matter paragraph in the assurance report describing the circumstances affecting the comparative information.

Other Information

64. The practitioner shall read other information included in documents containing the GHG statement and the assurance report thereon to identify material inconsistencies, if any, with

the GHG statement or the assurance report and, if on reading that other information, the practitioner: (Ref: Para.A139)

(a) Identifies a material inconsistency between that other information and the GHG statement or the assurance report; or

(b) Becomes aware of a material misstatement of fact in that other information that is unrelated to matters appearing in the GHG statement or the assurance report,

the practitioner shall discuss the matter with the entity and take further action as appropriate. (Ref: Para. A124–A126)

Documentation

65. In documenting the nature, timing and extent of procedures performed, the practitioner shall record: (Ref: Para. A127)

(a) The identifying characteristics of the specific items or matters tested;

(b) Who performed the engagement work and the date such work was completed; and

(c) Who reviewed the engagement work performed and the date and extent of such review.

66. The practitioner shall document discussions of significant matters with the entity and others, including the nature of the significant matters discussed, and when and with whom the discussions took place. (Ref: Para. A127)

Quality Control

67. The practitioner shall include in the engagement documentation:

(a) Issues identified with respect to compliance with relevant ethical requirements and how they were resolved;

(b) Conclusions on compliance with independence requirements that apply to the engagement, and any relevant discussions with the firm that support these conclusions;

(c) Conclusions reached regarding the acceptance and continuance of client relationships and assurance engagements; and

(d) The nature and scope of, and conclusions resulting from, consultations undertaken during the course of the engagement.

Matters Arising after the Date of the Assurance Report

68. If, in exceptional circumstances, the practitioner performs new or additional procedures or draws new conclusions after the date of the assurance report, the practitioner shall document: (Ref: Para. A128)

(a) The circumstances encountered;

(b) The new or additional procedures performed, evidence obtained, and conclusions reached, and their effect on the assurance report; and

(c) When and by whom the resulting changes to engagement documentation were made and reviewed.

Assembly of the Final Engagement File

69. The practitioner shall assemble the engagement documentation in an engagement file and complete the administrative process of assembling the final engagement file on a timely basis after the date of the assurance report. After the assembly of the final engagement file has been completed, the practitioner shall not delete or discard engagement documentation of any nature before the end of its retention period. (Ref: Para. A129)

70. In circumstances other than those envisaged in paragraph 68 where the practitioner finds it necessary to modify existing engagement documentation or add new engagement documentation after the assembly of the final engagement file has been completed, the practitioner shall, regardless of the nature of the modifications or additions, document:

    (a) The specific reasons for making them; and

    (b) When and by whom they were made and reviewed.

Engagement Quality Control Review

71. For those engagements, if any, for which a quality control review is required by law or regulation or for which the firm has determined that an engagement quality control review is required, the engagement quality control reviewer shall perform an objective evaluation of the significant judgments made by the engagement team, and the conclusions reached in formulating the assurance report. This evaluation shall involve: (Ref: Para. A130)

    (a) Discussion of significant matters with the engagement partner, including the engagement team's professional competencies with respect to the quantification and reporting of emissions and assurance;

    (b) Review of the GHG statement and the proposed assurance report;

    (c) Review of selected engagement documentation relating to the significant judgments the engagement team made and the conclusions it reached; and

    (d) Evaluation of the conclusions reached in formulating the assurance report and consideration of whether the proposed assurance report is appropriate.

Forming the Assurance Conclusion

72. The practitioner shall form a conclusion about whether the practitioner has obtained reasonable or limited assurance, as appropriate, about the GHG statement. That conclusion shall take into account the requirements of paragraphs 56 and 73–75 of this HKSAE.

Limited Assurance	Reasonable Assurance
73L. The practitioner shall evaluate whether anything has come to the practitioner's attention that causes the practitioner to believe that the GHG statement is not prepared, in all material respects, in accordance with the applicable criteria.	73R. The practitioner shall evaluate whether the GHG statement is prepared, in all material respects, in accordance with the applicable criteria.

74. This evaluation shall include consideration of the qualitative aspects of the entity's quantification methods and reporting practices, including indicators of possible bias in judgments and decisions in the making of estimates and in preparing the GHG statement,[13] and whether, in view of the applicable criteria:

(a) The quantification methods and reporting policies selected and applied are consistent with the applicable criteria and are appropriate;

(b) Estimates made in preparing the GHG statement are reasonable;

(c) The information presented in the GHG statement is relevant, reliable, complete, comparable and understandable;

(d) The GHG statement provides adequate disclosure of the applicable criteria, and other matters, including uncertainties, such that intended users can understand the significant judgments made in its preparation; and (Ref: Para. A29, A131–A133)

(e) The terminology used in the GHG statement is appropriate.

75. The evaluation required by paragraph 73 shall also include consideration of:

(a) The overall presentation, structure and content of the GHG statement; and

(b) When appropriate in the context of the criteria, the wording of the assurance conclusion, or other engagement circumstances, whether the GHG statement represents the underlying emissions in a manner that achieves fair presentation.

Assurance Report Content

76. The assurance report shall include, at a minimum, the following basic elements: (Ref: Para. A134)

(a) A title that clearly indicates the report is an independent assurance report.

(b) An addressee.

(c) An identification or description of the level of assurance, either reasonable or limited, obtained by the practitioner.

(d) Identification of the GHG statement, including the period(s) it covers, and, if any information in that statement is not covered by the practitioner's conclusion, clear identification of the information subject to assurance as well as the excluded information, together with a statement that the practitioner has not performed any procedures with respect to the excluded information and, therefore, that no conclusion on it is expressed. (Ref: Para. A120, A135)

(e) A description of the entity's responsibilities. (Ref: Para. A35)

(f) A statement that GHG quantification is subject to inherent uncertainty. (Ref: Para. A54–A59)

[13] Indicators of possible bias do not themselves constitute misstatements for the purposes of drawing conclusions on the reasonableness of individual estimates.

(g) If the GHG statement includes emissions deductions that are covered by the practitioner's conclusion, identification of those emissions deductions, and a statement of the practitioner's responsibility with respect to them. (Ref: Para. A136–A139)

(h) Identification of the applicable criteria;

(i) Identification of how those criteria can be accessed;

(ii) If those criteria are available only to specific intended users, or are relevant only to a specific purpose, a statement alerting readers to this fact and that, as a result, the GHG statement may not be suitable for another purpose. The statement shall also restrict the use of the assurance report to those intended users or that purpose; and (Ref: Para. A140–A141)

(iii) If established criteria need to be supplemented by disclosures in the explanatory notes to the GHG statement for those criteria to be suitable, identification of the relevant note(s). (Ref: Para. A131)

(i) A statement that the firm of which the practitioner is a member applies HKSQC 1, or other professional requirements, or requirements in law or regulation, that are at least as demanding as HKSQC 1. If the practitioner is not a professional accountant, the statement shall identify the professional requirements, or requirements in law or regulation, applied that are at least as demanding as HKSQC 1.

(j) A statement that the practitioner complies with the independence and other ethical requirements of the Code, or other professional requirements, or requirements imposed by law or regulation, that are at least as demanding as Parts A, B and D of the Code related to assurance engagements. If the practitioner is not a professional accountant, the statement shall identify the professional requirements, or requirements imposed by law or regulation, applied that are at least as demanding as Parts A, B and D of the Code related to assurance engagements.

(k) A description of the practitioner's responsibility, including:

(i) A statement that the engagement was performed in accordance with HKSAE 3410, *Assurance Engagements on Greenhouse Gas Statements*; and

(ii) An informative summary of the work performed as a basis for the practitioner's conclusion. In the case of a limited assurance engagement, an appreciation of the nature, timing, and extent of procedures performed is essential to understanding the practitioner's conclusion. In a limited assurance engagement, the summary of the work performed shall state that:

- The procedures performed in a limited assurance engagement vary in nature and timing from, and are less in extent than for, a reasonable assurance engagement; and

- Consequently, the level of assurance obtained in a limited assurance engagement is substantially lower than the assurance that would have been obtained had a reasonable assurance engagement been performed. (Ref: Para. A142–A144).

(l) The practitioner's conclusion:

(i) In a reasonable assurance engagement, the conclusion shall be expressed in a positive form; or

(ii) In a limited assurance engagement, the conclusion shall be expressed in a form that conveys whether, based on the procedures performed and evidence obtained, a matter(s) has come to the practitioner's attention to cause the practitioner to believe that the GHG statement is not prepared, in all material respects, in accordance with the applicable criteria.

(iii) When the practitioner expresses a modified conclusion, the assurance report shall contain:

a. A section that provides a description of the matter(s) giving rise to the modification; and

b. A section that contains the practitioner's modified conclusion.

(m) The practitioner’s signature. (Ref: Para. A145)

(n) The date of the assurance report. The assurance report shall be dated no earlier than the date on which the practitioner has obtained the evidence on which the practitioner's conclusion is based, including evidence that those with the recognized authority have asserted that they have taken responsibility for the GHG statement.

(o) The location in the jurisdiction where the practitioner practices.

Emphasis of Matter Paragraphs and Other Matter Paragraphs

77. If the practitioner considers it necessary to: (Ref: Para. A146–A152)

(a) Draw intended users’ attention to a matter presented or disclosed in the GHG statement that, in the practitioner’s judgment, is of such importance that it is fundamental to intended users’ understanding of the GHG statement (an Emphasis of Matter paragraph); or

(b) Communicate a matter other than those that are presented or disclosed in the GHG statement that, in the practitioner’s judgment, is relevant to intended users’ understanding of the engagement, the practitioner’s responsibilities or the assurance report (an Other Matter paragraph),

and this is not prohibited by law or regulation, the practitioner shall do so in a paragraph in the assurance report, with an appropriate heading, that clearly indicates the practitioner’s conclusion is not modified in respect of the matter.

Other Communication Requirements

78. The practitioner shall communicate, unless prohibited by law or regulation, with those person(s) with oversight responsibilities for the GHG statement the following matters that come to the practitioner’s attention during the course of the engagement, and shall determine whether there is a responsibility to report them to another party within or outside the entity:

(a) Deficiencies in internal control that, in the practitioner’s professional judgment, are of sufficient importance to merit attention;

(b) Identified or suspected fraud; and

(c) Matters involving identified or suspected non-compliance with laws and regulations, other than when the matters are clearly trivial. (Ref: Para. A87)

Conformity and Compliance with International Standards on Assurance Engagements

79. As of November 2012 *(date of issue)*, this HKSAE conforms with International Standard on Assurance Engagements (ISAE) 3410, "Assurance Engagements on Greenhouse Gas Statements". Compliance with the requirements of this HKSAE ensures compliance with ISAE 3410.

80. Additional local guidance is provided in footnotes 28, 30a, 32 and 34a.

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Application and Other Explanatory Material

Introduction

Assurance Engagements Covering Information in Addition to the GHG Statement (Ref: Para. 3)

A1. In some cases, the practitioner may perform an assurance engagement on a report that includes GHG information, but that GHG information does not comprise a GHG statement as defined in paragraph 14(m). In such cases, this HKSAE may provide guidance for such an engagement.

A2. Where a GHG statement is a relatively minor part of the overall information that is covered by the practitioner's conclusion, the extent to which this HKSAE is relevant is a matter for the practitioner's professional judgment in the circumstances of the engagement.

Key Performance Indicators Based on GHG Data (Ref: Para. 4(b))

A3. An example of a key performance indicator based on GHG data is the weighted average of emissions per kilometer of vehicles manufactured by an entity during a period, which is required to be calculated and disclosed by law or regulation in some jurisdictions.

Procedures for Reasonable Assurance and Limited Assurance Engagements (Ref: Para. 8)

A4. Some procedures that are required only for reasonable assurance engagements may nonetheless be appropriate in some limited assurance engagements. For example, although obtaining an understanding of control activities is not required for limited assurance engagements, in some cases, such as when information is recorded, processed, or reported only in electronic form, the practitioner may nonetheless decide that testing controls, and therefore obtaining an understanding of relevant control activities, is necessary for a limited assurance engagement (see also paragraph A90).

Independence (Ref: Para. 10 and 15)

A5. The Code adopts a threats and safeguards approach to independence. Compliance with the fundamental principles may potentially be threatened by a broad range of circumstances. Many threats fall into the following categories:

- Self-interest, for example, undue dependence on total fees from the entity.
- Self-review, for example, performing another service for the entity that directly affects the GHG statement, such as involvement in the quantification of the entity's emissions.

- Advocacy, for example, acting as an advocate on behalf of the entity with respect to the interpretation of the applicable criteria.
- Familiarity, for example, a member of the engagement team having a long association, or close or immediate family relationship, with an employee of the entity who is in a position to exert direct and significant influence over the preparation of the GHG statement.
- Intimidation, for example, being pressured to reduce inappropriately the extent of work performed in order to lower fees, or being threatened with withdrawal of the practitioner's registration by a registering authority that is associated with the entity's industry group.

A6. Safeguards created by the profession, law or regulation, or safeguards in the work environment, may eliminate or reduce such threats to an acceptable level.

Local Law or Regulation and the Provisions of an Emissions Trading Scheme (Ref: Para. 11)

A7. Local law or regulation or the provisions of an emissions trading scheme may: include requirements in addition to the requirements of this HKSAE; require that specific procedures be undertaken on all engagements; or require that procedures be undertaken in a particular way. For example, local laws or regulations or the provisions of an emissions trading scheme may require the practitioner to report in a format that is not in compliance with this HKSAE. When the law or regulation prescribes the layout or wording of the assurance report in a form or in terms that are significantly different from this HKSAE, and the practitioner concludes that additional explanation in the assurance report cannot mitigate possible misunderstanding, the practitioner may consider including a statement in the report that the engagement is not conducted in accordance with this HKSAE.

Definitions

Emissions (Ref: Para. 14(f), Appendix 1)

A8. Scope 1 emissions may include stationary combustion (from fuel burned in the entity's stationary equipment, such as boilers, incinerators, engines, and flares), mobile combustion (from fuel burned in the entity's transport devices, such as trucks, trains, airplanes and boats), process emissions (from physical or chemical processes, such as cement manufacturing, petrochemical processing, and aluminum smelting), and fugitive emissions (intentional and unintentional releases, such as equipment leaks from joints and seals and emissions from wastewater treatment, pits, and cooling towers).

A9. Almost all entities purchase energy in a form such as electricity, heat or steam; therefore, almost all entities have Scope 2 emissions. Scope 2 emissions are indirect because the emissions associated with, for example, electricity that the entity purchases occur at the power station, which is outside the entity's organizational boundary.

A10. Scope 3 emissions may include emissions associated with, for example: employee business travel; outsourced activities; consumption of fossil fuel or electricity required to use the entity's products; extraction and production of materials purchased as inputs to the entity's processes; and transportation of purchased fuels. Scope 3 emissions are further discussed in paragraphs A31–A34.

Emissions Deductions (Ref: Para. 14(g), 17(a)(iii), Appendix 1)

A11. In some cases, emissions deductions include jurisdiction-specific credits and allowances for which there is no established link between the quantity of emissions allowed by the criteria to be deducted, and any lowering of emissions that may occur as a result of money paid or other action taken by the entity in order for it to claim the emissions deduction.

A12. Where an entity's GHG statement includes emissions deductions that are within the scope of the engagement, the requirements of this HKSAE apply in relation to emissions deductions as appropriate (see also paragraphs A136-A139).

Purchased Offset (Ref: Para. 14(q), Appendix 1)

A13. When the entity purchases an offset from another entity, that other entity may spend the money it receives from the sale on emissions reduction projects (such as replacing energy generation using fossil fuels with renewable energy sources, or implementing energy efficiency measures), or on removing emissions from the atmosphere (for example, by planting and maintaining trees that would otherwise not have been planted or maintained), or the money may be compensation for not undertaking an action that would otherwise be undertaken (such as deforestation or forest degradation). In some jurisdictions, offsets can only be purchased if the emissions reduction or removal enhancement has already occurred.

Removal (Ref: Para. 14(s), Appendix 1)

A14. Removal may be achieved by storing GHGs in geological sinks (for example, underground) or biological sinks (for example, trees). Where the GHG statement includes the removal of GHGs that the entity would have otherwise emitted to the atmosphere, they are commonly reported in the GHG statement on a gross basis, that is, both the source and the sink are quantified in the GHG statement. Where removals are covered by the practitioner's conclusion, the requirements of this HKSAE apply in relation to those removals as appropriate.

Significant Facility (Ref: Para. 14(t) and 31)

A15. As the individual contribution of a facility to the aggregate emissions reported in the GHG statement increases, the risks of material misstatement to the GHG statement ordinarily increase. The practitioner may apply a percentage to a chosen benchmark as an aid to identify facilities that are of individual significance due to the size of their emissions relative to the aggregate emissions included in the GHG statement. Identifying a benchmark and determining a percentage to be applied to it involve the exercise of professional judgment. For example, the practitioner may consider that facilities exceeding 15% of total production volume are significant facilities. A higher or lower percentage may, however, be determined to be appropriate in the circumstances in the practitioner's professional judgment. This may be the case when, for example: there is a small number of facilities, none of which is less than 15% of total production volume, but in the practitioner's professional judgment not all the facilities are significant; or when there are a number of facilities that are marginally below 15% of total production volume which in the practitioner's professional judgment are significant.

A16. The practitioner may also identify a facility as significant due to its specific nature or circumstances which give rise to particular risks of material misstatement. For example, a facility could be using different data gathering processes or quantification techniques from other facilities, require the use of particularly complex or specialized calculations, or involve particularly complex or specialized chemical or physical processes.

HKSAE 3000 (Revised) (Ref: Para. 9, 15)

A17. HKSAE 3000 (Revised) includes requirements that apply to assurance engagements (other than audits or reviews of historical financial information), including engagements in accordance with this HKSAE. In some cases, this HKSAE may include additional requirements or application material in relation to those topics.

Acceptance and Continuance of the Engagement

Competency (Ref: Para. 16(b))

A18. GHG competencies may include:

- General understanding of climate science, including the scientific processes that relate GHGs to climate change.
- Understanding who the intended users of the information in the entity's GHG statement are, and how they are likely to use that information (see paragraph A47).
- Understanding emissions trading schemes and related market mechanisms, when relevant.
- Knowledge of applicable laws and regulations, if any, that affect how the entity should report its emissions, and may also, for example, impose a limit on the entity's emissions.
- GHG quantification and measurement methodologies, including the associated scientific and estimation uncertainties, and alternative methodologies available.
- Knowledge of the applicable criteria, including, for example:
    - ○ Identifying appropriate emissions factors.
    - ○ Identifying those aspects of the criteria that call for significant or sensitive estimates to be made, or for the application of considerable judgment.
    - ○ Methods used for determining organizational boundaries, i.e., the entities whose emissions are to be included in the GHG statement.
    - ○ Which emissions deductions are permitted to be included in the entity's GHG statement.

A19. The complexity of assurance engagements with respect to a GHG statement varies. In some cases, the engagement may be relatively straightforward, for instance, when an entity has no Scope 1 emissions and is reporting only Scope 2 emissions using an emissions factor specified in regulation, applied to electricity consumption at a single location. In this case, the engagement may focus largely on the system used to record and process electricity consumption figures identified on invoices, and arithmetical application of the specified emissions factor. When, however, the engagement is relatively complex, it is likely to require specialist competence in the quantification and reporting of emissions. Particular areas of expertise that may be relevant in such cases include:

Information systems expertise

- Understanding how emissions information is generated, including how data is initiated, recorded, processed, corrected as necessary, collated and reported in a GHG statement.

Scientific and engineering expertise

- Mapping the flow of materials through a production process, and the accompanying processes that create emissions, including identifying the relevant points at which source data is gathered. This may be particularly important in considering whether the entity's identification of emissions sources is complete.

- Analyzing chemical and physical relationships between inputs, processes and outputs, and relationships between emissions and other variables. The capacity to understand and analyze these relationships will often be important in designing analytical procedures.

- Identifying the effect of uncertainty on the GHG statement.

- Knowledge of the quality control policies and procedures implemented at testing laboratories, whether internal or external.

- Experience with specific industries and related emissions creation and removal processes. Procedures for Scope 1 emissions quantification vary greatly depending on the industries and processes involved, for example, the nature of electrolytic processes in aluminum production; combustion processes in the production of electricity using fossil fuels; and chemical processes in cement production are all different.

- The operation of physical sensors and other quantification methods, and the selection of appropriate emissions factors.

Scope of the GHG Statement and the Engagement (Ref: Para. 17(a))

A20. Examples of circumstances where the reasons for excluding known emissions sources from the GHG statement, or excluding disclosed emissions sources from the engagement, may not be reasonable in the circumstances include where:

- The entity has significant Scope 1 emissions but only includes Scope 2 emissions in the GHG statement.

- The entity is a part of a larger legal entity that has significant emissions that are not being reported on because of the way the organizational boundary has been determined when this is likely to mislead intended users.

- The emissions that the practitioner is reporting on are only a small proportion of the total emissions included in the GHG statement.

Determining the Appropriateness of the Subject Matter (Ref: Para. 15)

A21. HKSAE 3000 (Revised) requires the practitioner to determine whether the underlying subject matter is appropriate.[14] In the case of a GHG statement, the entity's emissions (and removals and emissions deductions if applicable) are the underlying subject matter of the engagement. That underlying subject matter will be appropriate if, among other things, the entity's emissions are capable of consistent quantification using suitable criteria.[15]

A22. GHG sources may be quantified by:

(a) Direct measurement (or direct monitoring) of GHG concentration and flow rates using continuous emissions monitoring or periodic sampling; or

[14] HKSAE 3000 (Revised), paragraph 24(b)(i)

[15] HKSAE 3000 (Revised), paragraphs 24(b)(ii)

(b) Measuring a surrogate activity, such as fuel consumption, and calculating emissions using, for example, mass balance equations,[16] entity-specific emissions factors, or average emissions factors for a region, source, industry or process.

Determining the Suitability of the Criteria

Specifically Developed and Established Criteria (Ref: Para. 17(b))

A23. Suitable criteria exhibit the following characteristics: relevance, completeness, reliability, neutrality, and understandability. Criteria may be "specifically developed" or they may be "established," for example, embodied in law or regulation, or issued by authorized or recognized bodies of experts that follow a transparent due process.[17] Although criteria established by a regulator can be presumed to be relevant when that regulator is the intended user, some established criteria may be developed for a special purpose and be unsuitable for application in other circumstances. For example, criteria developed by a regulator that include emissions factors for a particular region may render misleading information if used for emissions in another region; or criteria that are designed to report only on particular regulatory aspects of emissions may be unsuitable for reporting to intended users other than the regulator that established the criteria.

A24. Specifically developed criteria may be appropriate when, for example, the entity has very specialized machinery or is aggregating emissions information from different jurisdictions where the established criteria used in those jurisdictions differ. Special care may be necessary when assessing the neutrality and other characteristics of specifically developed criteria, particularly if they are not substantially based on established criteria generally used in the entity's industry or region, or are inconsistent with such criteria.

A25. The criteria may comprise established criteria supplemented by disclosures, in the explanatory notes to the GHG statement, of specific boundaries, methods, assumptions, emissions factors, etc. In some cases, established criteria may not be suitable, even when supplemented by disclosures in the explanatory notes to the GHG statement, for example, when they do not encompass the matters noted in paragraph 17(b).

A26. It should be noted that the suitability of the criteria is not affected by the level of assurance, that is, if they are not suitable for a reasonable assurance engagement, they are also not suitable for a limited assurance engagement, and vice versa.

Operations Included in the Entity's Organizational Boundary (Ref: Para. 17(b)(i), 23(b)(i), 34(g))

A27. Determining which operations owned or controlled by the entity to include in the entity's GHG statement is known as determining the entity's organizational boundary. In some cases, law or regulation define the boundaries of the entity for reporting GHG emissions for regulatory purposes. In other cases, the applicable criteria may allow a choice between different methods for determining the entity's organizational boundary, for example, the criteria may allow a choice between an approach that aligns the entity's GHG statement with its financial statements and another approach that treats, for example, joint ventures or associates differently. Determining the entity's organizational boundary may require the analysis of complex organizational structures such as joint ventures, partnerships, and trusts, and complex or unusual contractual relationships. For example, a facility may be owned by one party, operated by another, and process materials solely for another party.

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[16] That is, equating the amount of a substance entering and exiting a defined boundary, for example, the amount of carbon in a hydrocarbon-based fuel entering a combustion device equals the amount of carbon exiting the device in the form of carbon dioxide.

[17] HKSAE 3000 (Revised), paragraphs A45–A48

A28. Determining the entity's organizational boundary is different from what some criteria describe as determining the entity's "operational boundary." The operational boundary relates to which categories of Scope 1, 2 and 3 emissions will be included in the GHG statement, and is determined after setting the organizational boundary.

Adequate Disclosures (Ref: Para. 17(b)(iv), 74(d))

A29. In regulatory disclosure regimes, disclosures specified in the relevant law or regulation are adequate for reporting to the regulator. Disclosure in the GHG statement of such matters as the following may be necessary in voluntary reporting situations for intended users to understand the significant judgments made in preparing the GHG statement:

(a) Which operations are included in the entity's organizational boundary, and the method used for determining that boundary if the applicable criteria allow a choice between different methods (see paragraphs A27–A28);

(b) Significant quantification methods and reporting policies selected, including:

(i) The method used to determine which Scope 1 and Scope 2 emissions have been included in the GHG statement (see paragraph A30);

(ii) Any significant interpretations made in applying the applicable criteria in the entity's circumstances, including data sources and, when choices between different methods are allowed, or entity-specific methods are used, disclosure of the method used and the rationale for doing so; and

(iii) How the entity determines whether previously reported emissions should be restated.

(c) The categorization of emissions in the GHG statement. As noted in paragraph A14, where the GHG statement includes the removal of GHGs that the entity would have otherwise emitted to the atmosphere, both emissions and removals are commonly reported in the GHG statement on a gross basis, that is, both the source and the sink are quantified in the GHG statement;

(d) A statement regarding the uncertainties relevant to the entity's quantification of its emissions, including: their causes; how they have been addressed; their effects on the GHG statement; and, where the GHG statement includes Scope 3 emissions, an explanation of: (see paragraphs A31–A34)

(i) The nature of Scope 3 emissions, including that it is not practicable for an entity to include all Scope 3 emissions in its GHG statement; and

(ii) The basis for selecting those Scope 3 emissions sources that have been included; and

(e) Changes, if any, in the matters mentioned in this paragraph or in other matters that materially affect the comparability of the GHG statement with a prior period(s) or base year.

Scope 1 and Scope 2 Emissions

A30. Criteria commonly call for all material Scope 1, Scope 2, or both Scope 1 and Scope 2 emissions to be included in the GHG statement. Where some Scope 1 or Scope 2 emissions have been excluded, it is important that the explanatory notes to the GHG statement disclose the basis for determining which emissions are included and which are excluded, particularly if those that are included are not likely to be the largest for which the entity is responsible.

Scope 3 Emissions

A31. While some criteria require the reporting of specific Scope 3 emissions, more commonly the inclusion of Scope 3 emissions is optional because it would be impracticable for nearly any entity to attempt to quantify the full extent of its indirect emissions as this includes all sources both up and down the entity's supply chain. For some entities, reporting particular categories of Scope 3 emissions provides important information for intended users, for example, where an entity's Scope 3 emissions are considerably larger than its Scope 1 and Scope 2 emissions, as may be the case with many service sector entities. In these cases, the practitioner may consider it inappropriate to undertake an assurance engagement if significant Scope 3 emissions are not included in the GHG statement.

A32. Where some Scope 3 emissions sources have been included in the GHG statement, it is important that the basis for selecting which sources to include is reasonable, particularly if those included are not likely to be the largest sources for which the entity is responsible.

A33. In some cases, the source data used to quantify Scope 3 emissions may be maintained by the entity. For example, the entity may keep detailed records as the basis for quantifying emissions associated with employee air travel. In some other cases, the source data used to quantify Scope 3 emissions may be maintained in a well-controlled and accessible source outside the entity. Where this is not the case, however, it may be unlikely that the practitioner will be able to obtain sufficient appropriate evidence with respect to such Scope 3 emissions. In such cases, it may be appropriate to exclude those Scope 3 emissions sources from the engagement.

A34. It may also be appropriate to exclude Scope 3 emissions from the engagement where the quantification methods in use are heavily dependent on estimation and lead to a high degree of uncertainty in reported emissions. For example, various quantification methods for estimating the emissions associated with air travel can give widely varying quantifications even when identical source data is used. If such Scope 3 emissions sources are included in the engagement, it is important that the quantification methods used are selected objectively and that they are fully described along with the uncertainties associated with their use.

The Entity's Responsibility for the Preparation of the GHG Statement (Ref: Para. 17(c)(ii), 76(d))

A35. As noted in paragraph A70, for some engagements concerns about the condition and reliability of an entity's records may cause the practitioner to conclude that it is unlikely that sufficient appropriate evidence will be available to support an unmodified conclusion on the GHG statement. This may occur when the entity has little experience with the preparation of GHG statements. In such circumstances, it may be more appropriate for the quantification and reporting of emissions to be subject to an agreed-upon procedures engagement or a consulting engagement in preparation for an assurance engagement in a later period.

Who Developed the Criteria (Ref: Para. 17(c)(iii))

A36. When the GHG statement has been prepared for a regulatory disclosure regime or emissions trading scheme where the applicable criteria and form of reporting are prescribed, it is likely to be apparent from the engagement circumstances that it is the regulator or body in charge of the scheme that developed the criteria. In voluntary reporting situations, however, it may not be clear who developed the criteria unless it is stated in the explanatory notes to the GHG statement.

Changing the Terms of the Engagement (Ref: Para. 15, 18)

A37. HKSAE 3000 (Revised) requires that the practitioner not agree to a change in the terms of the engagement where there is no reasonable justification for doing so.[18] A request to change the scope of the engagement may not have a reasonable justification when, for example, the request is made to exclude certain emissions sources from the scope of the engagement because of the likelihood that the practitioner's conclusion would be modified.

Planning (Ref: Para. 19)

A38. When establishing the overall engagement strategy, it may be relevant to consider the emphasis given to different aspects of the design and implementation of the GHG information system. For example, in some cases the entity may have been particularly conscious of the need for adequate internal control to ensure the reliability of reported information, while in other cases the entity may have focused more on accurately determining the scientific, operational or technical characteristics of the information to be gathered.

A39. Smaller engagements or more straightforward engagements (see paragraph A19) may be conducted by a very small engagement team. With a smaller team, coordination of, and communication between, team members is easier. Establishing the overall engagement strategy for a smaller engagement, or for a more straightforward engagement, need not be a complex or time-consuming exercise. For example, a brief memorandum, based on discussions with the entity, may serve as the documented engagement strategy if it covers the matters noted in paragraph 19.

A40. The practitioner may decide to discuss elements of planning with the entity when determining the scope of the engagement or to facilitate the conduct and management of the engagement (for example, to coordinate some of the planned procedures with the work of the entity's personnel). Although these discussions often occur, the overall engagement strategy and the engagement plan remain the practitioner's responsibility. When discussing matters included in the overall engagement strategy or engagement plan, care is required in order not to compromise the effectiveness of the engagement. For example, discussing the nature and timing of detailed procedures with the entity may compromise the effectiveness of the engagement by making the procedures too predictable.

A41. The performance of an assurance engagement is an iterative process. As the practitioner performs planned procedures, the evidence obtained may cause the practitioner to modify the nature, timing or extent of other planned procedures. In some cases, information may come to the practitioner's attention that differs significantly from that expected at an earlier stage of the engagement. For example, systematic errors discovered when performing procedures on location at selected facilities may indicate that it is necessary to visit additional facilities.

Planning to Use a Practitioner's Expert or Another Practitioner (Ref: Para. 19(e))

A42. The engagement may be performed by a multi-disciplinary team that includes one or more experts, particularly on relatively complex engagements when specialist competence in the quantification and reporting of emissions is likely to be required (see paragraph A19). HKSAE 3000 (Revised) contains a number of requirements with respect to using the work of an expert that may need to be considered at the planning stage when ascertaining the nature, timing and extent of resources necessary to perform the engagement.[19]

A43. The work of another practitioner may be used in relation to, for example, a factory or other form of facility at a remote location; a subsidiary, division or branch in a foreign jurisdiction; or

[18] HKSAE 3000 (Revised), paragraph 29

[19] HKSAE 3000 (Revised), paragraphs 45(c), 52, and 54

a joint venture or associate. Relevant considerations when the engagement team plans to request another practitioner to perform work on information to be included in the GHG statement may include:

- Whether the other practitioner understands and complies with the ethical requirements that are relevant to the engagement and, in particular, is independent.
- The other practitioner's professional competence.
- The extent of the engagement team's involvement in the work of the other practitioner.
- Whether the other practitioner operates in a regulatory environment that actively oversees that practitioner.

Materiality in Planning and Performing the Engagement

Determining Materiality When Planning the Engagement (Ref: Para. 20–21)

A44. The criteria may discuss the concept of materiality in the context of the preparation and presentation of the GHG statement. Although criteria may discuss materiality in different terms, the concept of materiality generally includes that:

- Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence relevant decisions of users taken on the basis of the GHG statement;
- Judgments about materiality are made in light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both; and
- Judgments about matters that are material to intended users of the GHG statement are based on a consideration of the common information needs of intended users as a group. Unless the engagement has been designed to meet the particular information needs of specific users, the possible effect of misstatements on specific users, whose information needs may vary widely, is not ordinarily considered.

A45. Such a discussion, if present in the applicable criteria, provides a frame of reference to the practitioner in determining materiality for the engagement. If the applicable criteria do not include a discussion of the concept of materiality, the characteristics referred to above provide the practitioner with such a frame of reference.

A46. The practitioner's determination of materiality is a matter of professional judgment, and is affected by the practitioner's perception of the common information needs of intended users as a group. In this context, it is reasonable for the practitioner to assume that intended users:

(a) Have a reasonable knowledge of GHG related activities, and a willingness to study the information in the GHG statement with reasonable diligence;

(b) Understand that the GHG statement is prepared and assured to levels of materiality, and have an understanding of any materiality concepts included in the applicable criteria;

(c) Understand that the quantification of emissions involves uncertainties (see paragraphs A54–A59); and

(d) Make reasonable decisions on the basis of the information in the GHG statement.

A47. Intended users and their information needs may include, for example:

- Investors and other stakeholders such as suppliers, customers, employees, and the broader community in the case of voluntary disclosures. Their information needs may relate to decisions to buy or sell equity in the entity; lend to, trade with, or be employed by the entity; or make representations to the entity or others, for example, politicians.

- Market participants in the case of an emissions trading scheme, whose information needs may relate to decisions to trade negotiable instruments (such as permits, credits or allowances) created by the scheme, or impose fines or other penalties on the basis of excess emissions.

- Regulators and policy makers in the case of a regulatory disclosure regime. Their information needs may relate to monitoring compliance with the disclosure regime, and a broad range of government policy decisions related to climate change mitigation and adaptation, usually based on aggregated information.

- Management and those charged with governance of the entity who use information about emissions for strategic and operational decisions, such as choosing between alternative technologies and investment and divestment decisions, perhaps in anticipation of a regulatory disclosure regime or entering an emissions trading scheme.

The practitioner may not be able to identify all those who will read the assurance report, particularly where there are a large number of people who have access to it. In such cases, particularly where possible users are likely to have a broad range of interests with respect to emissions, intended users may be limited to major stakeholders with significant and common interests. Intended users may be identified in different ways, for example, by agreement between the practitioner and the engaging party, or by law or regulation.

A48. Judgments about materiality are made in light of surrounding circumstances, and are affected by both quantitative and qualitative factors. It should be noted, however, that decisions regarding materiality are not affected by the level of assurance, that is, materiality for a reasonable assurance engagement is the same as for a limited assurance engagement.

A49. A percentage is often applied to a chosen benchmark as a starting point in determining materiality. Factors that may affect the identification of an appropriate benchmark and percentage include:

- The elements included in the GHG statement (for example, Scope 1, Scope 2 and Scope 3 emissions, emissions deductions, and removals). A benchmark that may be appropriate, depending on the circumstances, is gross reported emissions, that is, the aggregate of reported Scope 1, Scope 2 and Scope 3 emissions before subtracting any emissions deductions or removals. Materiality relates to the emissions covered by the practitioner's conclusion. Therefore, when the practitioner's conclusion does not cover the entire GHG statement, materiality is set in relation to only that portion of the GHG statement that is covered by the practitioner's conclusion as if it were the GHG statement.

- The quantity of a particular type of emission or the nature of a particular disclosure. In some cases, there are particular types of emissions or disclosures for which misstatements of lesser or greater amounts than materiality for the GHG statement in its entirety are acceptable. For example, the practitioner may consider it appropriate to set a lower or greater materiality for emissions from a particular jurisdiction, or for a particular gas, scope or facility.

- How the GHG statement presents relevant information, for example, whether it includes a comparison of emissions with a prior period(s), a base year, or a "cap," in which case determining materiality in relation to the comparative information may be a relevant consideration. Where a "cap" is relevant, materiality may be set in relation to the entity's allocation of the cap if it is lower than reported emissions.

- The relative volatility of emissions. For example, if emissions vary significantly from period to period, it may be appropriate to set materiality relative to the lower end of the fluctuation range even if the current period is higher.

- The requirements of the applicable criteria. In some cases, the applicable criteria may set a threshold for accuracy and may refer to this as materiality. For example, the criteria may state an expectation that emissions are measured using a stipulated percentage as the "materiality threshold." Where this is the case, the threshold set by the criteria provides a frame of reference to the practitioner in determining materiality for the engagement.

A50. Qualitative factors may include:

- The sources of emissions.

- The types of gases involved.

- The context in which the information in the GHG statement will be used (for example, whether the information is for use in an emissions trading scheme, is for submission to a regulator, or is for inclusion in a widely distributed sustainability report); and the types of decisions that intended users are likely to make.

- Whether there are one or more types of emissions or disclosures on which the attention of the intended users tends to be focused, for example, gases that, as well as contributing to climate change, are ozone depleting.

- The nature of the entity, its climate change strategies and progress toward related objectives.

- The industry and the economic and regulatory environment in which the entity operates.

Revision as the Engagement Progresses (Ref: Para. 22)

A51. Materiality may need to be revised as a result of a change in circumstances during the engagement (for example, the disposal of a major part of the entity's business), new information, or a change in the practitioner's understanding of the entity and its operations as a result of performing procedures. For example, it may become apparent during the engagement that actual emissions are likely to be substantially different from those used initially to determine materiality. If during the engagement the practitioner concludes that a lower materiality for the GHG statement (and, if applicable, materiality level or levels for particular types of emissions or disclosures) than that initially determined is appropriate, it may be necessary to revise performance materiality, and the nature, timing and extent of the further procedures.

Understanding the Entity and Its Environment, Including the Entity's Internal Control, and Identifying and Assessing Risks of Material Misstatement (Ref: Para. 23–26)

A52. The practitioner uses professional judgment to determine the extent of the understanding and the nature, timing and extent of procedures to identify and assess risks of material misstatement that are required to obtain reasonable or limited assurance, as appropriate. The practitioner's primary consideration is whether the understanding that has been obtained and the identification and assessment of risks are sufficient to meet the objective stated in this HKSAE. The depth of the understanding that is required by the practitioner is less than that possessed by management in managing the entity, and both the depth of the understanding and the nature, timing and extent of procedures to identify and assess risks of material misstatement are less for a limited assurance engagement than for a reasonable assurance engagement.

A53. Obtaining an understanding and identifying and assessing risks of material misstatement is an iterative process. Procedures to obtain an understanding of the entity and its environment and to identify and assess risks of material misstatement by themselves do not provide sufficient appropriate evidence on which to base the assurance conclusion.

Uncertainty (Ref: Para: 23(b)(i)c, 76(e))

A54. The GHG quantification process can rarely be 100% accurate due to:

(a) *Scientific uncertainty*: This arises because of incomplete scientific knowledge about the measurement of GHGs. For example, the rate of GHG sequestration in biological sinks, and the "global warming potential" values used to combine emissions of different gases and report them as carbon dioxide equivalents, are subject to incomplete scientific knowledge. The degree to which scientific uncertainty affects the quantification of reported emissions is beyond the control of the entity. However, the potential for scientific uncertainty to result in unreasonable variations in reported emissions can be negated by the use of criteria that stipulate particular scientific assumptions to be used in preparing the GHG statement, or particular factors that embody those assumptions; and

(b) *Estimation (or measurement) uncertainty*: This results from the measurement and calculation processes used to quantify emissions within the bounds of existing scientific knowledge. Estimation uncertainty may relate to the data on which an estimate is based (for example, it may relate to uncertainty inherent in measurement instruments used), or the method, including where applicable the model, used in making the estimate (sometimes known as parameter and model uncertainty, respectively). The degree of estimation uncertainty is often controllable by the entity. Reducing the degree of estimation uncertainty may involve greater cost.

A55. The fact that quantifying an entity's emissions is subject to uncertainty does not mean that an entity's emissions are inappropriate as a subject matter. For example, the applicable criteria may require Scope 2 emissions from electricity to be calculated by applying a prescribed emissions factor to the number of kilowatt hours consumed. The prescribed emissions factor will be based on assumptions and models that may not hold true in all circumstances. However, as long as the assumptions and models are reasonable in the circumstances and adequately disclosed, information in the GHG statement will ordinarily be capable of being subjected to an assurance engagement.

A56. The situation in paragraph A55 can be contrasted with quantification in accordance with criteria that use models and assumptions based on an entity's individual circumstances. Using entity-specific models and assumptions will likely result in more accurate quantification than using, for example, average emissions factors for an industry; it will also likely introduce additional risks of material misstatement with respect to how the entity-specific models and assumptions were arrived at. As noted in paragraph A55, as long as the assumptions and models are reasonable in the circumstances and adequately disclosed, information in the GHG statement will ordinarily be capable of being subjected to an assurance engagement.

A57. In some cases, however, the practitioner may decide that it is inappropriate to undertake an assurance engagement if the impact of uncertainty on information in the GHG statement is very high. This may be the case when, for example, a significant proportion of the entity's reported emissions are from fugitive sources (see paragraph A8) that are not monitored and estimation methods are not sufficiently sophisticated, or when a significant proportion of the entity's reported removals are attributable to biological sinks. It should be noted that decisions whether to undertake an assurance engagement in such circumstances are not affected by the level of assurance, that is, if it is not appropriate for a reasonable assurance engagement, it is also not appropriate for a limited assurance engagement, and vice versa.

A58. A discussion in the explanatory notes to the GHG statement of the nature, causes, and effects of the uncertainties that affect the entity's GHG statement alerts intended users to the uncertainties associated with the quantification of emissions. This may be particularly important where the intended users did not determine the criteria to be used. For example, a GHG statement may be available to a broad range of users even though the criteria used were developed for a particular regulatory purpose.

A59. Because uncertainty is a significant characteristic of all GHG statements, paragraph 76(e) requires it to be mentioned in the assurance report regardless of what, if any, disclosures are included in the explanatory notes to the GHG statement.[20]

The Entity and Its Environment

Interruptions to Operations (Ref: Para. 23(b)(iii))

A60. Interruptions may include incidents such as shut downs, which may occur unexpectedly, or may be planned, for example, as part of a maintenance schedule. In some cases, the nature of operations may be intermittent, for example, when a facility is only used at peak periods.

Climate Change Objectives and Strategies (Ref: Para. 23(e))

A61. Consideration of the entity's climate change strategy, if any, and associated economic, regulatory, physical and reputational risks, may assist the practitioner to identify risks of material misstatement. For example, if the entity has made commitments to become carbon neutral, this may provide an incentive to understate emissions so the target will appear to be achieved within a declared timeframe. Conversely, if the entity is expecting to be subject to a regulated emissions trading scheme in the future, this may provide an incentive to overstate emissions in the meantime to increase the opportunity for it to receive a larger allowance at the outset of the scheme.

Procedures to Obtain an Understanding and to Identify and Assess Risks of Material Misstatement (Ref: Para. 24)

A62. Although the practitioner is required to perform all the procedures in paragraph 24 in the course of obtaining the required understanding of the entity, the practitioner is not required to perform all of them for each aspect of that understanding.

Analytical Procedures for Obtaining an Understanding of the Entity and Its Environment and Identifying and Assessing Risks of Material Misstatement (Ref: Para. 24(b))

A63. Analytical procedures performed to obtain an understanding of the entity and its environment and to identify and assess risks of material misstatement may identify aspects of the entity of which the practitioner was unaware and may assist in assessing the risks of material misstatement in order to provide a basis for designing and implementing responses to the assessed risks. Analytical procedures may include, for example, comparing GHG emissions from various facilities with production figures for those facilities.

A64. Analytical procedures may help identify the existence of unusual events, and amounts, ratios, and trends that might indicate matters that have implications for the engagement. Unusual or unexpected relationships that are identified may assist the practitioner in identifying risks of material misstatement.

A65. However, when such analytical procedures use data aggregated at a high level (which may be the situation with analytical procedures performed to obtain an understanding of the entity and

[20] See also HKSAE 3000 (Revised), paragraph 69(e).

its environment and to identify and assess risks of material misstatement), the results of those analytical procedures only provide a broad initial indication about whether a material misstatement may exist. Accordingly, in such cases, consideration of other evidence that has been gathered when identifying the risks of material misstatement together with the results of such analytical procedures may assist the practitioner in understanding and evaluating the results of the analytical procedures.

Observation and Inspection (Ref: Para. 24(c))

A66. Observation consists of looking at a process or procedure being performed by others, for example, the practitioner's observation of monitoring devices being calibrated by the entity's personnel, or of the performance of control activities. Observation provides evidence about the performance of a process or procedure, but is limited to the point in time at which the observation takes place, and by the fact that the act of being observed may affect how the process or procedure is performed.

A67. Inspection involves:

(a) Examining records or documents, whether internal or external, in paper form, electronic form, or other media, for example, calibration records of a monitoring device. Inspection of records and documents provides evidence of varying degrees of reliability, depending on their nature and source and, in the case of internal records and documents, on the effectiveness of the controls over their production; or

(b) A physical examination of, for example, a calibrating device.

A68. Observation and inspection may support inquiries of management and others, and may also provide information about the entity and its environment. Examples of such procedures include observation or inspection of the following:

- The entity's operations. Observing processes and equipment, including monitoring equipment, at facilities may be particularly relevant where significant Scope 1 emissions are included in the GHG statement.

- Documents (such as emissions mitigation plans and strategies), records (such as calibration records and results from testing laboratories), and manuals detailing information collection procedures and internal controls.

- Reports prepared for management or those charged with governance, such as internal or external reports with respect to the entity's environmental management systems.

- Reports prepared by management (such as quarterly management reports) and those charged with governance (such as minutes of board of directors' meetings).

Obtaining an Understanding of the Entity's Internal Control (Ref: Para. 25L–26R)

A69. In a limited assurance engagement, the practitioner is not required to obtain an understanding of all of the components of the entity's internal control relevant to emissions quantification and reporting as is required in a reasonable assurance engagement. In addition, the practitioner is not required to evaluate the design of controls and determine whether they have been implemented. Therefore, in a limited assurance engagement, while it may often be appropriate to inquire of the entity about control activities and monitoring of controls relevant to the quantification and reporting of emissions, it will often not be necessary to obtain a detailed understanding of these components of the entity's internal control.

A70. The practitioner's understanding of relevant components of internal control may raise doubts about whether sufficient appropriate evidence is available for the practitioner to complete the engagement. For example (see also paragraphs A71–A72, A92–A93, and A96):

- Concerns about the integrity of those preparing the GHG statement may be so serious as to cause the practitioner to conclude that the risk of management misrepresentation in the GHG statement is such that an engagement cannot be conducted.

- Concerns about the condition and reliability of an entity's records may cause the practitioner to conclude that it is unlikely that sufficient appropriate evidence will be available to support an unmodified conclusion on the GHG statement.

Control Activities Relevant to the Engagement (Ref: Para. 25R(d))

A71. The practitioner's judgment about whether particular control activities are relevant to the engagement may be affected by the level of sophistication, documentation and formality of the entity's information system, including the related business processes, relevant to reporting emissions. As reporting of emissions evolves, it can be expected that so too will the level of sophistication, documentation and formality of information systems and related control activities relevant to the quantification and reporting of emissions.

A72. In the case of very small entities or immature information systems, particular control activities are likely to be more rudimentary, less well-documented, and may only exist informally. When this is the case, it is less likely the practitioner will judge it necessary to understand particular control activities in order to assess the risks of material misstatement and design further procedures responsive to assessed risks. In some regulated schemes, on the other hand, the information system and control activities may be required to be formally documented and their design approved by the regulator. Even in some of these cases, however, not all relevant data flows and associated controls may be documented. For example, it may be more likely that control activities with respect to source data collection from continuous monitoring are sophisticated, well-documented, and more formal than control activities with respect to subsequent data processing and reporting (see also paragraphs A70, A92–A93, and A96).

Other Engagements Performed for the Entity (Ref: Para. 27)

A73. Information obtained from other engagements performed for the entity may relate to, for example, aspects of the entity's control environment.

Performing Procedures on Location at the Entity's Facilities (Ref: Para. 31)

A74. Performing observation and inspection, as well as other procedures, on location at a facility (often referred to as a "site visit") may be important in building on the understanding of the entity that the practitioner develops by performing procedures at head office. Because the practitioner's understanding of the entity and identification and assessment of risks of material misstatement can be expected to be more comprehensive for a reasonable assurance engagement than for a limited assurance engagement, the number of facilities at which procedures are performed on location in the case of a reasonable assurance engagement will ordinarily be greater than in the case of a limited assurance engagement.

A75. Performing procedures on location at a facility (or having another practitioner perform such procedures on behalf of the practitioner) may be done as part of planning, when performing procedures to identify and assess risks of material misstatement, or when responding to assessed risks of material misstatement. Performing procedures at significant facilities is often particularly important for an engagement being undertaken for the first time when considering the completeness of Scope 1 sources and of sinks included in the GHG statement, and when establishing whether the entity's data collection and processing systems, and its estimation techniques, are appropriate relative to the underlying physical processes and related uncertainties.

A76. As noted in paragraph A74, performing procedures on location at a facility may be important in building on the understanding of the entity that the practitioner develops by performing procedures at head office. For many reasonable assurance engagements, the practitioner will also judge it necessary to perform procedures on location at each significant facility to respond to assessed risks of material misstatement, particularly when the entity has significant facilities with Scope 1 emissions. For a limited assurance engagement where the entity has a number of significant facilities with Scope 1 emissions, a meaningful level of assurance may not be able to be obtained without the practitioner having performed procedures at a selection of significant facilities. Where the entity has significant facilities with Scope 1 emissions and the practitioner determines that effective and efficient procedures cannot be performed on location at the facility by the practitioner (or another practitioner on their behalf), alternative procedures may include one or more of the following:

- Reviewing source documents, energy flow diagrams, and material flow diagrams.
- Analyzing questionnaire responses from facility management.
- Inspecting satellite imagery of the facility.

A77. To obtain adequate coverage of total emissions, particularly in a reasonable assurance engagement, the practitioner may decide that it is appropriate to perform procedures on location at a selection of facilities that are not significant facilities. Factors that may be relevant to such a decision include:

- The nature of emissions at different facilities. For example, it is more likely that a practitioner may choose to visit a facility with Scope 1 emissions than a facility with only Scope 2 emissions. In the latter case, the examination of energy invoices at head office is more likely to be a primary source of evidence.
- The number and size of facilities, and their contribution to overall emissions.
- Whether facilities use different processes, or processes using different technologies. Where this is the case, it may be appropriate to perform procedures on location at a selection of facilities using different processes or technologies.
- The methods used at different facilities to gather emissions information.
- The experience of relevant staff at different facilities.
- Varying the selection of facilities over time.

Internal Audit (Ref: Para. 32)

A78. The entity's internal audit function is likely to be relevant to the engagement if the nature of the internal audit function's responsibilities and activities are related to the quantification and reporting of emissions and the practitioner expects to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of procedures to be performed.

Risks of Material Misstatement at the GHG Statement Level (Ref: Para. 33L(a)–33R(a))

A79. Risks of material misstatement at the GHG statement level refer to risks that relate pervasively to the GHG statement as a whole. Risks of this nature are not necessarily risks identifiable with a specific type of emission or disclosure level. Rather, they represent circumstances that may increase the risks of material misstatement more generally, for example, through management override of internal control. Risks of material misstatement at the GHG statement level may be especially relevant to the practitioner's consideration of the risks of material misstatement arising from fraud.

A80. Risks at the GHG statement level may derive in particular from a deficient control environment. For example, deficiencies such as management's lack of competence may have a pervasive effect on the GHG statement and may require an overall response by the practitioner. Other risks of material misstatement at the GHG statement level may include, for example:

- Inadequate, poorly controlled or poorly documented mechanisms for collecting data, quantifying emissions and preparing GHG statements.
- Lack of staff competence in collecting data, quantifying emissions and preparing GHG statements.
- Lack of management involvement in quantifying emissions and preparing GHG statements.
- Failure to identify accurately all sources of GHGs.
- Risk of fraud, for example, in connection with emissions trading markets.
- Presenting information covering prior periods that is not prepared on a consistent basis, for example, because of changed boundaries or changes in measurement methodologies.
- Misleading presentation of information in the GHG statement, for example, unduly highlighting particularly favorable data or trends.
- Inconsistent quantification methods and reporting policies, including different methods for determining the organizational boundary, at different facilities.
- Errors in unit conversion when consolidating information from facilities.
- Inadequate disclosure of scientific uncertainties and key assumptions in relation to estimates.

The Use of Assertions (Ref: Para. 33L(b–)33R(b))

A81. Assertions are used by the practitioner in a reasonable assurance engagement, and may be used in a limited assurance engagement, to consider the different types of potential misstatements that may occur.

A82. In representing that the GHG statement is in accordance with the applicable criteria, the entity implicitly or explicitly makes assertions regarding the quantification, presentation and disclosure of emissions. Assertions fall into the following categories and may take the following forms:

(a) Assertions about the quantification of emissions for the period subject to assurance:

(i) Occurrence—emissions that have been recorded have occurred and pertain to the entity.

(ii) Completeness—all emissions that should have been recorded have been recorded (see paragraphs A30–A34 for a discussion of completeness with respect to various Scopes).

(iii) Accuracy—the quantification of emissions has been recorded appropriately.

(iv) Cutoff—emissions have been recorded in the correct reporting period.

(v) Classification—emissions have been recorded as the proper type.

(b) Assertions about presentation and disclosure:

  (i) Occurrence and responsibility—disclosed emissions and other matters have occurred and pertain to the entity.

  (ii) Completeness—all disclosures that should have been included in the GHG statement have been included.

  (iii) Classification and understandability—emissions information is appropriately presented and described, and disclosures are clearly expressed.

  (iv) Accuracy and quantification—emissions quantification and related information included in the GHG statement are appropriately disclosed.

  (v) Consistency—quantification policies are consistent with those applied in the prior period, or changes are justified and have been properly applied and adequately disclosed; and comparative information, if any, is as reported in the prior period or has been appropriately restated.

Reliance on Internal Control (Ref: Para. 33R)

A83. If the practitioner's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively (that is, the practitioner intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of other procedures), the practitioner is required by paragraph 38R to design and perform tests of the operating effectiveness of those controls.

Causes of Risks of Material Misstatement (Ref: Para. 34)

Fraud (Ref: Para. 28, 34(a))

A84. Misstatements in the GHG statement can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the GHG statement is intentional or unintentional.

A85. Incentives for intentional misstatement of the GHG statement may arise if, for example, those who are directly involved with, or have the opportunity to influence, the emissions reporting process have a significant portion of their compensation contingent upon achieving aggressive GHG targets. As noted in paragraph A61, other incentives to either under or overstate emissions may result from the entity's climate change strategy, if any, and associated economic, regulatory, physical and reputational risks.

A86. Although fraud is a broad legal concept, for the purposes of this HKSAE, the practitioner is concerned with fraud that causes a material misstatement in the GHG statement. Although the practitioner may suspect or, in rare cases, identify the occurrence of fraud, the practitioner does not make legal determinations of whether fraud has actually occurred.

Non-Compliance with Law and Regulation (Ref: Para. 34(b), 78(c))

A87. This HKSAE distinguishes the practitioner's responsibilities in relation to compliance with two different categories of law and regulation as follows:

(a) The provisions of law and regulation generally recognized to have a direct effect on the determination of material amounts and disclosures in the GHG statement in that they determine the reported quantities and disclosures in an entity's GHG statement. Paragraph 34(b) requires the practitioner to consider the likelihood of material misstatement due to non-compliance with the provisions of such law or regulation when performing the procedures required by paragraphs 33L or 33R; and

(b) Other law or regulation that do not have a direct effect on the determination of the quantities and disclosures in the GHG statement, but compliance with which may be fundamental to the operating aspects of the business, to an entity's ability to continue its business, or to avoid material penalties (for example, compliance with the terms of an operating license, or compliance with environmental regulations). Planning and performing an engagement with professional skepticism, as required by HKSAE 3000 (Revised),[21] is important in the context of remaining alert to the possibility that procedures applied for the purpose of forming a conclusion on the GHG statement may bring instances of identified or suspected non-compliance with such law or regulation to the practitioner's attention.

Other Causes of Risks of Material Misstatement (Ref: Para. 34)

A88. Examples of factors referred to in paragraph 34(c)–(k) include:

(a) Omission of one or more emissions sources is more likely for sources that are less obvious and may be overlooked, such as fugitive emissions.

(b) Significant economic or regulatory changes may include, for example, increases in renewable energy targets or significant price changes for allowances under an emissions trading scheme, which may lead to, for example, increased risk of misclassification of sources at an electricity generator.

(c) The nature of the entity's operations may be complex (for example, it may involve multiple and disparate facilities and processes), discontinuous (for example, peak load electricity generation), or result in few or weak relationships between the entity's emissions and other measurable activity levels (for example, a cobalt nickel plant). In such cases, the opportunity for meaningful analytical procedures may be significantly reduced.

Changes in operations or boundaries (for example, introduction of new processes, or the sale, acquisition or outsourcing of emissions sources or removal sinks) may also introduce risks of material misstatement (for example, through unfamiliarity with quantification or reporting procedures). Also, double counting of an emissions source or removals sink may occur due to inadequate coordination in the identification of sources and sinks at a complex installation.

(d) Selection of an inappropriate quantification method (for example, calculating Scope 1 emissions using an emissions factor when using a more accurate direct measurement method is available and would be more appropriate). Selecting an appropriate quantification method is particularly important when the method has been changed. This is because intended users are often interested in emissions trends over time, or relative to a base year. Some criteria may require that quantification methods are only changed when a more accurate method is to be used. Other factors related to the nature of quantification methods include:

- Incorrect application of a quantification method, such as not calibrating meters or not reading them sufficiently frequently, or use of an emissions factor that is inappropriate in the circumstances. For example, an emissions factor may be predicated on an assumption of continuous use and may not be appropriate to use after a shut down.

[21] HKSAE 3000 (Revised), paragraph 37

- Complexity in quantification methods, which will likely involve higher risk of material misstatement, for example: extensive or complex mathematical manipulation of source data (such as the use of complex mathematical models); extensive use of state conversion factors (such as those to convert measures of liquid to measures of gas); or extensive use of unit conversion factors (such as those to convert imperial measures to metric measures).

- Changes in quantification methods or input variables (for example, if the quantification method used is based on the carbon content of biomass, and the composition of the biomass used changes during the period).

(e) Significant non-routine emissions or judgmental matters are a source of greater risk of material misstatement relative to routine, non-complex emissions that are subject to systematic quantification and reporting. Non-routine emissions are those that are unusual, in size or nature, and that therefore occur infrequently (for example, one-off events such as a plant malfunction or major leak). Judgmental matters may include the development of subjective estimates. Risks of material misstatement may be greater because of matters such as:

- Greater management intervention to specify the quantification methods or reporting treatment.

- Greater manual intervention for data collection and processing.

- Complex calculations or quantification methods and reporting principles.

- The nature of non-routine emissions, which may make it difficult for the entity to implement effective controls over the risks.

- Quantification methods and reporting principles for estimates may be subject to differing interpretation.

- Required judgments may be subjective or complex.

(f) The inclusion of Scope 3 emissions where the source data used in quantification are not maintained by the entity, or where quantification methods commonly in use are imprecise or lead to large variations in reported emissions (see paragraphs A31–A34).

(g) Matters that the practitioner may consider in obtaining an understanding of how the entity makes significant estimates and the data on which they are based include, for example:

- An understanding of the data on which estimates are based;

- The method, including where applicable the model, used in making estimates;

- Relevant aspects of the control environment and information system;

- Whether the entity has used an expert;

- The assumptions underlying estimates;

- Whether there has been or ought to have been a change from the prior period in the methods for making estimates and, if so, why; and

- Whether and, if so, how the entity has assessed the effect of estimation uncertainty on the GHG statement, including:

- ○ Whether and, if so, how the entity has considered alternative assumptions or outcomes by, for example, performing a sensitivity analysis to determine the effect of changes in the assumptions on an estimate;

- ○ How the entity determines the estimate when analysis indicates a number of outcome scenarios; and

- ○ Whether the entity monitors the outcome of estimates made in the prior period, and whether it has appropriately responded to the outcome of that monitoring procedure.

A89. Examples of other factors that may lead to risks of material misstatement include:

- Human error in the quantification of emissions, which may be more likely to occur if personnel are unfamiliar with, or not well-trained regarding, emissions processes or data recording.

- Undue reliance on a poorly designed information system, which may have few effective controls, for example, the use of spreadsheets without adequate controls.

- Manual adjustment of otherwise automatically recorded activity levels, for example, manual input may be required if a flare meter becomes overloaded.

- Significant external developments such as heightened public scrutiny of a particular facility.

Overall Responses to Assessed Risks of Material Misstatement and Further Procedures

Limited and Reasonable Assurance Engagements (Ref: Para. 8, 35–41R, 42L–43R, 46)

A90. Because the level of assurance obtained in a limited assurance engagement is lower than in a reasonable assurance engagement, the procedures the practitioner will perform in a limited assurance engagement vary in nature and timing from, and are less in extent than for, a reasonable assurance engagement. The primary differences between the practitioner's overall responses to address the assessed risks of material misstatement and further procedures for a reasonable assurance engagement and a limited assurance engagement on a GHG statement include:

(a) The emphasis placed on the nature of various procedures as a source of evidence will likely differ, depending on the engagement circumstances. For example:

- The practitioner may judge it to be appropriate in the circumstances of a particular limited assurance engagement to place relatively greater emphasis on inquiries of the entity's personnel and analytical procedures, and relatively less emphasis, if any, on tests of controls and obtaining evidence from external sources than may be the case for a reasonable assurance engagement.

- Where the entity uses continuous measuring equipment to quantify emissions flows, the practitioner may decide in a limited assurance engagement to respond to an assessed risk of material misstatement by inquiring about the frequency with which the equipment is calibrated. In the same circumstances for a reasonable assurance engagement, the practitioner may decide to examine the entity's records of the equipment's calibration or independently test its calibration.

- Where the entity burns coal, the practitioner may decide in a reasonable assurance engagement to independently analyze the characteristics of the coal, but in a limited assurance engagement the practitioner may decide that reviewing the entity's records of laboratory test results is an adequate response to an assessed risk of material misstatement.

(b) In a limited assurance engagement, the further procedures performed are less than in a reasonable assurance engagement. This may involve:

- Selecting less items for examination;
- Performing fewer procedures (for example, performing only analytical procedures in circumstances when, in a reasonable assurance engagement, both analytical procedures and tests of detail would be performed); or
- Performing procedures on location at fewer facilities.

(c) In a reasonable assurance engagement, analytical procedures performed in response to assessed risks of material misstatement involve developing expectations of quantities or ratios that are sufficiently precise to identify material misstatements. In a limited assurance engagement, analytical procedures may be designed to support expectations regarding the direction of trends, relationships and ratios rather than to identify misstatements with the level of precision expected in a reasonable assurance engagement.[22]

Further, when significant fluctuations, relationships or differences are identified, appropriate evidence in a limited assurance engagement may often be obtained by making inquiries of the entity and considering responses received in the light of known engagement circumstances, without obtaining additional evidence as is required by paragraph 43R(a) in the case of a reasonable assurance engagement.

In addition, when undertaking analytical procedures in a limited assurance engagement the practitioner may, for example:

- Use data that is more highly aggregated, for example, data at a regional level rather than at a facility level, or monthly data rather than weekly data.
- Use data that has not been subjected to separate procedures to test its reliability to the same extent as it would be for a reasonable assurance engagement.

Overall Responses to Assessed Risks of Material Misstatement (Ref: Para. 35)

A91. Overall responses to address the assessed risks of material misstatement at the GHG statement level may include:

- Emphasizing to the assurance personnel the need to maintain professional skepticism.
- Assigning more experienced staff or those with special skills or using experts.
- Providing more supervision.
- Incorporating additional elements of unpredictability in the selection of further procedures to be performed.
- Making general changes to the nature, timing, or extent of procedures, for example: performing procedures at the period end instead of at an interim date; or modifying the nature of procedures to obtain more persuasive evidence.

[22] This may not always be the case; for example, in some circumstances the practitioner may develop a precise expectation based on fixed physical or chemical relationships even in a limited assurance engagement.

A92. The assessment of the risks of material misstatement at the GHG statement level, and thereby the practitioner's overall responses, is affected by the practitioner's understanding of the control environment. An effective control environment may allow the practitioner to have more confidence in internal control and the reliability of evidence generated internally within the entity and thus, for example, allow the practitioner to conduct some procedures at an interim date rather than at the period end. Deficiencies in the control environment, however, have the opposite effect. For example, the practitioner may respond to an ineffective control environment by:

- Conducting more procedures as of the period end rather than at an interim date.
- Obtaining more extensive evidence from procedures other than tests of controls.
- Increasing sample sizes and the extent of procedures, such as the number of facilities at which procedures are performed.

A93. Such considerations, therefore, have a significant bearing on the practitioner's general approach, for example, the relative emphasis on tests of controls versus other procedures (see also paragraphs A70–A72, and A96).

Examples of Further Procedures (Ref: Para. 37L–37R, 40R)

A94. Further procedures may include, for example:

- Testing the operating effectiveness of controls over the collection and recording of activity data, such as kilowatt hours of electricity purchased.
- Agreeing emissions factors to appropriate sources (for example, government publications), and considering their applicability in the circumstances.
- Reviewing joint venture agreements and other contracts relevant to determining the entity's organizational boundary.
- Reconciling recorded data to, for example, odometers on vehicles owned by the entity.
- Reperforming calculations (for example, mass balance and energy balance calculations), and reconciling differences noted.
- Taking readings from continuous monitoring equipment.
- Observing or reperforming physical measurements, such as dipping oil tanks.
- Analyzing the soundness and appropriateness of unique measurement or quantification techniques, particularly complex methods that may involve, for example, recycle or feedback loops.
- Sampling and independently analyzing the characteristics of materials such as coal, or observing the entity's sampling techniques and reviewing records of laboratory test results.
- Checking the accuracy of calculations and the suitability of calculation methods used (for example, the conversion and aggregation of input measurements).
- Agreeing recorded data back to source documents, such as production records, fuel usage records, and invoices for purchased energy.

Factors that May Influence Assessed Risks of Material Misstatement (Ref: Para. 37L(a)–37R(a))

A95. Factors that may influence the assessed risks of material misstatement include:

- Inherent limitations on the capabilities of measurement instruments and the frequency of their calibration.
- The number, nature, geographical spread, and ownership characteristics of facilities from which data is collected.
- The number and nature of the various gases and emissions sources included in the GHG statement.
- Whether processes to which emissions relate are continuous or intermittent, and the risk of disruption to such processes.
- The complexity of methods for activity measurement and for calculating emissions, for example, some processes require unique measurement and calculation methods.
- The risk of unidentified fugitive emissions.
- The extent to which the quantity of emissions correlates with readily available input data.
- Whether personnel who perform data collection are trained in relevant methods, and the frequency of turnover of such personnel.
- The nature and level of automation used in data capture and manipulation.
- The quality control policies and procedures implemented at testing laboratories, whether internal or external.
- The complexity of criteria and of quantification and reporting policies, including how the organizational boundary is determined.

Operating Effectiveness of Controls (Ref: Para. 37R(a)(ii), 38R(a))

A96. In the case of very small entities or immature information systems, there may not be many control activities that could be identified by the practitioner, or the extent to which their existence or operation have been documented by the entity may be limited. In such cases, it may be more efficient for the practitioner to perform further procedures that are primarily other than tests of controls. In some rare cases, however, the absence of control activities or of other components of control may make it impossible to obtain sufficient appropriate evidence (see also paragraphsA70–A72, and A92–A93).

Persuasiveness of Evidence (Ref: Para. 37L(b)–37R(b))

A97. To obtain more persuasive evidence because of a higher assessment of risk of material misstatement, the practitioner may increase the quantity of the evidence, or obtain evidence that is more relevant or reliable, for example, by obtaining corroborating evidence from a number of independent sources.

Risks for Which Tests of Controls Are Necessary to Provide Sufficient Appropriate Evidence (Ref: 38R(b))

A98. The quantification of emissions may include processes that are highly automated with little or no manual intervention, for example, where relevant information is recorded, processed, or reported only in electronic form such as in a continuous monitoring system, or when the processing of activity data is integrated with an information technology-based operational or financial reporting system. In such cases:

- Evidence may be available only in electronic form, and its sufficiency and appropriateness dependent on the effectiveness of controls over its accuracy and completeness.

- The potential for improper initiation or alteration of information to occur and not be detected may be greater if appropriate controls are not operating effectively.

Confirmation Procedures (Ref: Para. 41R)

A99. External confirmation procedures may provide relevant evidence about such information as:

- Activity data collected by a third party, such as data about: employee air travel collated by a travel agent; the inflow of energy to a facility metered by a supplier; or kilometers travelled by entity-owned vehicles recorded by an external fleet manager.

- Industry benchmark data used in calculating emissions factors.

- The terms of agreements, contracts, or transactions between the entity and other parties, or information about whether other parties are, or are not, including particular emissions in their GHG statement, when considering the entity's organizational boundary.

- The results of laboratory analysis of samples (for example, the calorific value of input samples).

Analytical Procedures Performed in Response to Assessed Risks of Material Misstatement (Ref: Para. 42L–42R)

A100. In many cases, the fixed nature of physical or chemical relationships between particular emissions and other measurable phenomena allows for the design of powerful analytical procedures (for example, the relationship between fuel consumption and carbon dioxide and nitrous oxide emissions).

A101. Similarly, a reasonably predictable relationship may exist between emissions and financial or operational information (for example, the relationship between Scope 2 emissions from electricity and the general ledger balance for electricity purchases or hours of operation). Other analytical procedures may involve comparisons of information about the entity's emissions with external data such as industry averages; or the analysis of trends during the period to identify anomalies for further investigation, and trends across periods for consistency with other circumstances such as the acquisition or disposal of facilities.

A102. Analytical procedures may be particularly effective when disaggregated data is readily available, or when the practitioner has reason to consider the data to be used is reliable, such as when it is extracted from a well-controlled source. In some cases, data to be used may be captured by the financial reporting information system, or may be entered in another information system in parallel with the entry of related financial data, and some common input controls applied. For example, the quantity of fuel purchased as recorded on suppliers' invoices may be input under the same conditions that relevant invoices are entered into an accounts payable system. In some cases, data to be used may be an integral input to operational decisions and therefore subject to increased scrutiny by operational personnel, or subject to separate external audit procedures (for example, as part of a joint venture agreement or oversight by a regulator).

Procedures Regarding Estimates (Ref: Para. 44L–45R)

A103. In some cases, it may be appropriate for the practitioner to evaluate how the entity has considered alternative assumptions or outcomes, and why it has rejected them.

A104. In some limited assurance engagements, it may be appropriate for the practitioner to undertake one or more of the procedures identified in paragraph 45R.

Sampling (Ref: Para. 46)

A105. Sampling involves:

(a) Determining a sample size sufficient to reduce sampling risk to an acceptably low level. Because the acceptable level of assurance engagement risk is lower for a reasonable assurance engagement than for a limited assurance engagement, so too may be the level of sampling risk that is acceptable in the case of tests of details. Therefore, when sampling is used for tests of details in a reasonable assurance engagement, the sample size may be larger than when used in similar circumstances in a limited assurance engagement.

(b) Selecting items for the sample in such a way that each sampling unit in the population has a chance of selection, and performing procedures, appropriate to the purpose, on each item selected. If the practitioner is unable to apply the designed procedures, or suitable alternative procedures, to a selected item, that item is treated as a deviation from the prescribed control, in the case of tests of controls, or a misstatement, in the case of tests of details.

(c) Investigating the nature and cause of deviations or misstatements identified, and evaluating their possible effect on the purpose of the procedure and on other areas of the engagement.

(d) Evaluating:

(i) The results of the sample, including, for tests of details, projecting misstatements found in the sample to the population; and

(ii) Whether the use of sampling has provided an appropriate basis for conclusions about the population that has been tested.

Fraud, Law and Regulation (Ref: Para. 47)

A106. In responding to fraud or suspected fraud identified during the engagement, it may be appropriate for the practitioner to, for example:

- Discuss the matter with the entity.
- Request the entity to consult with an appropriately qualified third party, such as the entity's legal counsel or a regulator.
- Consider the implications of the matter in relation to other aspects of the engagement, including the practitioner's risk assessment and the reliability of written representations from the entity.
- Obtain legal advice about the consequences of different courses of action.
- Communicate with third parties (for example, a regulator).

- Withhold the assurance report.

- Withdraw from the engagement.

A107. The actions noted in the paragraph A106 may be appropriate in responding to non-compliance or suspected non-compliance with law and regulation identified during the engagement. It may also be appropriate to describe the matter in an Other Matter paragraph in the assurance report in accordance with paragraph 77 of this HKSAE, unless the practitioner:

(a) Concludes that the non-compliance has a material effect on the GHG statement and has not been adequately reflected in the GHG statement; or

(b) Is precluded by the entity from obtaining sufficient appropriate evidence to evaluate whether non-compliance that may be material to the GHG statement has, or is likely to have, occurred, in which case paragraph 66 of HKSAE 3000 (Revised) applies.

Procedures Regarding the GHG Statement Aggregation Process (Ref: Para. 48L–48R)

A108. As noted in paragraph A71, as reporting of emissions evolves, it can be expected that so too will the level of sophistication, documentation and formality of information systems relevant to the quantification and reporting of emissions. In immature information systems, the aggregation process may be very informal. In more sophisticated systems, the aggregation process may be more systematic and formally documented. The nature, and also the extent, of the practitioner's procedures with respect to adjustments and the manner in which the practitioner agrees or reconciles the GHG statement with the underlying records depends on the nature and complexity of the entity's quantifications and reporting process and the related risks of material misstatement.

Additional Procedures (Ref: Para. 49L–49R)

A109. An assurance engagement is an iterative process, and information may come to the practitioner's attention that differs significantly from that on which the determination of planned procedures was based. As the practitioner performs planned procedures, the evidence obtained may cause the practitioner to perform additional procedures. Such procedures may include asking the entity to examine the matter(s) identified by the practitioner, and to make adjustments to the GHG statement if appropriate.

Determining Whether Additional Procedures Are Necessary in a Limited Assurance Engagement (Ref: Para. 49L, 49L(b))

A110. The practitioner may become aware of a matter(s) that causes the practitioner to believe the GHG statement may be materially misstated. For example, when performing site visits, the practitioner may identify a potential source of emissions which does not appear to be included in the GHG statement. In such cases, the practitioner makes further inquiries as to whether the potential source has been incorporated into the GHG statement. The extent of additional procedures performed, in accordance with paragraph 49L, will be a matter of professional judgment. The greater the likelihood of material misstatement the more persuasive the evidence the practitioner obtains.

A111. If, in the case of a limited assurance engagement, a matter(s) comes to the practitioner's attention that causes the practitioner to believe the GHG statement may be materially misstated, the practitioner is required by paragraph 49L to design and perform additional procedures. If having done so, however, the practitioner is not able to obtain sufficient appropriate evidence to either conclude that the matter(s) is not likely to cause the GHG statement to be materially misstated or determine that it does cause the GHG statement to be materially misstated, a scope limitation exists.

Accumulation of Identified Misstatements (Ref: Para. 50)

A112. The practitioner may designate an amount below which misstatements would be clearly trivial and would not need to be accumulated because the practitioner expects that the accumulation of such amounts clearly would not have a material effect on the GHG statement. "Clearly trivial" is not another expression for "not material." Matters that are clearly trivial will be of a wholly different (smaller) order of magnitude than materiality determined in accordance with this HKSAE, and will be matters that are clearly inconsequential, whether taken individually or in the aggregate and whether judged by any criteria of size, nature or circumstances. When there is any uncertainty about whether one or more items are clearly trivial, the matter is considered not to be clearly trivial.

Using the Work of Another Practitioners

Communication to Another Practitioners (Ref: Para. 57(a))

A113. Relevant matters that the engagement team may communicate to another practitioners in respect of the work to be performed, the use to be made of that work, and the form and content of the other practitioner's communication with the engagement team may include:

- A request that the other practitioner, knowing the context in which the engagement team will use the work of the other practitioner, confirms that the other practitioner will cooperate with the engagement team.
- Performance materiality for the work of the other practitioner, which may be lower than performance materiality for the GHG statement (and, if applicable, the materiality level or levels for particular types of emissions or disclosures) and the threshold above which misstatements cannot be regarded as clearly trivial to the GHG statement.
- Identified risks of material misstatement of the GHG statement that are relevant to the work of the other practitioner; and a request that the other practitioner communicate on a timely basis any other risks identified during the engagement that may be material to the GHG statement, and the other practitioner's responses to such risks.

Communication from Another Practitioners (Ref: Para. 57(a))

A114. Relevant matters that the engagement team may request another practitioner to communicate include:

- Whether the other practitioner has complied with ethical requirements that are relevant to the group engagement, including independence and professional competence.
- Whether the other practitioner has complied with the group engagement team's requirements.
- Information on instances of non-compliance with law or regulation that could give rise to a material misstatement of the GHG statement.
- A list of uncorrected misstatements identified by the other practitioner during the engagement that are not clearly trivial.
- Indicators of possible bias in the preparation of relevant information.
- Description of any identified significant deficiencies in internal control identified by the other practitioner during the engagement.

- Other significant matters that the other practitioner has communicated or expects to communicate to the entity, including fraud or suspected fraud.

- Any other matters that may be relevant to the GHG statement, or that the other practitioner wishes to draw to the attention of the engagement team, including exceptions noted in any written representations that the other practitioner requested from the entity.

- The other practitioner's overall findings, conclusion or opinion.

Evidence (Ref: Para. 57(b))

A115. Relevant considerations when obtaining evidence regarding the work of another practitioner may include:

- Discussions with the other practitioner regarding business activities relevant to that other practitioner's work that are significant to the GHG statement.

- Discussions with the other practitioner regarding the susceptibility of relevant information to material misstatement.

- Reviewing the other practitioner's documentation of identified risks of material misstatement, responses to those risks, and conclusions. Such documentation may take the form of a memorandum that reflects the other practitioner's conclusion with regard to the identified risks.

Written Representations (Ref: Para. 58)

A116. In addition to the written representations required by paragraph 58, the practitioner may consider it necessary to request other written representations. The person(s) from whom the practitioner requests written representations will ordinarily be a member of senior management or those charged with governance. However, because management and governance structures vary by jurisdiction and by entity, reflecting influences such as different cultural and legal backgrounds, and size and ownership characteristics, it is not possible for this HKSAE to specify for all engagements the appropriate person(s) from whom to request written representations. For example, the entity may be a facility that is not a separate legal entity in its own right. In such cases, identifying the appropriate management personnel or those charged with governance from whom to request written representations may require the exercise of professional judgment.

Subsequent Events (Ref: Para. 61)

A117. Subsequent events may include, for example, the publication of revised emissions factors by a body such as a government agency, changes to relevant legislation or regulations, improved scientific knowledge, significant structural changes in the entity, the availability of more accurate quantification methods, or the discovery of a significant error.

Comparative Information (Ref: Para. 62–63, 76(c))

A118. Law or regulation, or the terms of the engagement, may specify the requirements in respect of presentation, reporting and assurance of the comparative information in a GHG statement. A key difference between financial statements and a GHG statement is that the amounts presented in a GHG statement measures emissions for a discrete period and are not based on cumulative amounts over time. As a result, the comparative information presented does not affect current year information unless emissions have been recorded in the wrong period and therefore the amounts may be based on the incorrect starting period for measurement.

A119. Where a GHG statement includes references to percentage reductions in emissions, or a similar comparison of period on period information, it is important that the practitioner consider the appropriateness of the comparisons. These may be inappropriate due to:

(a) Significant changes in operations from the prior period;

(b) Significant changes in conversion factors; or

(c) Inconsistency of sources or methods of measurement.

A120. When comparative information is presented with the current emissions information but some or all of that comparative information is not covered by the practitioner's conclusion, it is important that the status of such information is clearly identified in both the GHG statement and the assurance report.

Restatements (Ref: Para. 62(a))

A121. The GHG quantities reported in a prior period may need to be restated in accordance with law or regulation or the applicable criteria because of, for example, improved scientific knowledge, significant structural changes in the entity, the availability of more accurate quantification methods, or the discovery of a significant error.

Performing Procedures on Comparative Information (Ref: Para 63(a))

A122. In a limited assurance engagement that includes assurance on comparative information, if the practitioner becomes aware that there may be a material misstatement in the comparative information presented, the procedures to be performed are to be in accordance with the requirements of paragraph 49L. In the case of a reasonable assurance engagement, the procedures to be performed are to be sufficient to form an opinion on the comparative information.

A123. If the engagement does not include assurance on comparative information, the requirement to perform procedures in the circumstances addressed by paragraph 63(a) is to satisfy the practitioner's ethical obligation to not knowingly be associated with materially false or misleading information.

Other Information (Ref: Para. 64)

A124. A GHG statement may be published with other information that is not covered by the practitioner's conclusion, for example, a GHG statement may be included as part of an entity's annual report or sustainability report, or included with other climate change-specific information such as:

- A strategic analysis, including a statement about the impact climate change has on the entity's strategic objectives.
- An explanation and qualitative assessment of current and anticipated significant risks and opportunities associated with climate change.
- Disclosures about the entity's actions, including its long-term and short-term plan to address climate change-related risks, opportunities and impacts.
- Disclosures about future outlook, including trends and factors related to climate change that are likely to affect the entity's strategy or the timescale over which achievement of the strategy is planned.

- A description of governance processes and the entity's resources that have been assigned to the identification, management and oversight of climate change-related issues.

A125. In some cases, the entity may publish emissions information that is calculated on a different basis from that used in preparing the GHG statement, for example, the other information may be prepared on a "like-for-like" basis whereby emissions are recalculated to omit the effect of non-recurring events, such as the commissioning of a new plant or the closing down of a facility. The practitioner may seek to have such information removed if the methods used to prepare it would be disallowed by the criteria used to prepare the GHG statement. The practitioner may also seek to have removed any narrative information that is inconsistent with the quantitative data included in the GHG statement or cannot be substantiated (for example, speculative projections or claims about future action).

A126. Further actions that may be appropriate when other information could undermine the credibility of the GHG statement and the assurance report include, for example:

- Requesting the entity to consult with a qualified third party, such as the entity's legal counsel.
- Obtaining legal advice about the consequences of different courses of action.
- Communicating with third parties, for example, a regulator.
- Withholding the assurance report.
- Withdrawing from the engagement, where withdrawal is possible under applicable law or regulation.
- Describing the matter in the assurance report.

Documentation

Documentation of the Procedures Performed and Evidence Obtained (Ref: Para. 15, 65–66)

A127. HKSAE 3000 (Revised) requires the practitioner to prepare on a timely basis engagement documentation that provides a record of the basis of the assurance report.[23] The following are examples of matters that may be appropriate to include in the engagement documentation:

- Fraud: The risks of material misstatement and the nature, timing and extent of procedures with respect to fraud; and communications about fraud made to the entity, regulators and others.
- Law or Regulation: Identified or suspected non-compliance with law or regulation and the results of discussion with the entity and other parties outside the entity.
- Planning: The overall engagement strategy, the engagement plan, and any significant changes made during the engagement, and the reasons for such changes.
- Materiality: The following amounts and the factors considered in their determination: materiality for the GHG statement; if applicable, the materiality level or levels for particular types of emissions or disclosures; performance materiality; and any revision of materiality as the engagement progresses.

[23] HKSAE 3000 (Revised), paragraph 79

- Risks of Material Misstatement: the discussion required by paragraph 29, and the significant decisions reached, key elements of the understanding obtained regarding each of the aspects of the entity and its environment specified in paragraph 23, and the risks of material misstatement for which in the practitioner's professional judgment further procedures were required.

- Further Procedures: the nature, timing and extent of the further procedures performed, the linkage of those further procedures with the risks of material misstatement, and the results of the procedures.

- Evaluation of Misstatements: The amount below which misstatements would be regarded as clearly trivial, misstatements accumulated during the engagement and whether they have been corrected, and the practitioner's conclusion as to whether uncorrected misstatements are material, individually or in the aggregate, and the basis for that conclusion.

Matters Arising after the Date of the Assurance Report (Ref: Para. 68)

A128. Examples of exceptional circumstances include facts which become known to the practitioner after the date of the assurance report but which existed at that date and which, if known at that date, might have caused the GHG statement to be amended or the practitioner to modify the conclusion in the assurance report, for example, the discovery of a significant uncorrected error. The resulting changes to the engagement documentation are reviewed in accordance with the firm's policies and procedures with respect to review responsibilities as required by HKSQC 1, with the engagement partner taking final responsibility for the changes.[24]

Assembly of the Final Engagement File (Ref: Para. 69)

A129. HKSQC 1 (or other professional requirements, or requirements in law or regulation, that are at least as demanding as HKSQC 1) requires firms to establish policies and procedures for the timely completion of the assembly of engagement files.[25] An appropriate time limit within which to complete the assembly of the final engagement file is ordinarily not more than 60 days after the date of the assurance report.[26]

Engagement Quality Control Review (Ref: Para. 71)

A130. Other matters that may be considered in an engagement quality control review include:

- The engagement team's evaluation of the firm's independence in relation to the engagement.

- Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations.

- Whether engagement documentation selected for review reflects the work performed in relation to the significant judgments and supports the conclusions reached.

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[24] HKSQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements,* paragraphs 32–33

[25] HKSQC 1, paragraph 45

[26] HKSQC 1, paragraph A54

Forming the Assurance Conclusion

Description of the Applicable Criteria (Ref: Para. 74(d), 76(g)(iv))

A131. The preparation of the GHG statement by the entity requires the inclusion of an adequate description of the applicable criteria in the explanatory notes to the GHG statement. That description advises intended users of the framework on which the GHG statement is based, and is particularly important when there are significant differences between various criteria regarding how particular matters are treated in a GHG statement, for example: which emissions deductions are included, if any; how they have been quantified and what they represent; and the basis for selecting which Scope 3 emissions are included, and how they have been quantified.

A132. A description that the GHG statement is prepared in accordance with particular criteria is appropriate only if the GHG statement complies with all the requirements of those criteria that are effective during the period covered by the GHG statement.

A133. A description of the applicable criteria that contains imprecise qualifying or limiting language (for example, "the GHG statement is in substantial compliance with the requirements of XYZ") is not an adequate description as it may mislead users of the GHG statement.

Assurance Report Content

Illustrative Assurance Reports (Ref: Para. 76)

A134. Appendix 2 contains illustrations of assurance reports on GHG statements incorporating the elements set forth in paragraph 76.

Information Not Covered by the Practitioner's Conclusion (Ref: Para. 76(c))

A135. To avoid misunderstanding and undue reliance on information that has not been subject to assurance, where the GHG statement includes information, such as comparatives, that is not covered by the practitioner's conclusion, that information is ordinarily identified as such in the GHG statement and in the practitioner's assurance report.

Emissions Deductions (Ref: Para. 76(f))

A136. The wording of the statement to be included in the assurance report when the GHG statement includes emissions deductions may vary considerably depending on the circumstances.

A137. The availability of relevant and reliable information in relation to offsets and other emissions deductions varies greatly and, therefore, so does the evidence available to practitioners to support entities' claimed emissions deductions.

A138. Because of the varied nature of emissions deductions and the often reduced number and nature of procedures that can be applied to emissions deductions by the practitioner, this HKSAE requires identification in the assurance report of those emissions deductions, if any, that are covered by the practitioner's conclusion, and a statement of the practitioner's responsibility with respect to them.

A139. A statement of the practitioner's responsibility with respect to emissions deductions may be worded as follows when the emissions deductions are comprised of offsets: "The GHG statement includes a deduction from ABC's emissions for the year of yyy tonnes of $CO_{2\text{-}e}$ relating to offsets. We have performed procedures as to whether these offsets were acquired during the year, and whether the description of them in the GHG statement is a reasonable summary of the relevant contracts and related documentation. We have not, however, performed any procedures regarding the external providers of these offsets, and express no conclusion about whether the offsets have resulted, or will result, in a reduction of yyy tonnes of $CO_{2\text{-}e}$."

Use of the Assurance Report (Ref: Para. 76(g)(iii))

A140. As well as identifying the addressee of the assurance report, the practitioner may consider it appropriate to include wording in the body of the assurance report that specifies the purpose for which, or the intended users for whom, the report was prepared. For example, when the GHG statement will be lodged on the public record, it may be appropriate for the explanatory notes to the GHG statement and the assurance report to include a statement that the report is intended for users who have a reasonable knowledge of GHG related activities, and who have studied the information in the GHG statement with reasonable diligence and understand that the GHG statement is prepared and assured to appropriate levels of materiality.

A141. In addition, the practitioner may consider it appropriate to include wording that specifically restricts distribution of the assurance report other than to intended users, its use by others, or its use for other purposes.

Summary of the Practitioner's Procedures (Ref: Para. 76(h)(ii))

A142. The assurance report in a reasonable assurance engagement normally follows a standard wording and only briefly describes procedures performed. This is because, in a reasonable assurance engagement, describing in any level of detail the specific procedures performed would not assist users to understand that, in all cases where an unmodified report is issued, sufficient appropriate evidence has been obtained to enable the practitioner to express an opinion.

A143. In a limited assurance engagement, an appreciation of the nature, timing and extent of procedures performed is essential for the intended users to understand the conclusion expressed in a limited assurance report. The description of the practitioner's procedures in a limited assurance engagement is therefore ordinarily more detailed than in a reasonable assurance engagement. It also may be appropriate to include a description of procedures that were not performed that would ordinarily be performed in a reasonable assurance engagement. However, a complete identification of all such procedures may not be possible because the practitioner's required understanding and assessment of risks of material misstatement are less than in a reasonable assurance engagement.

Factors to consider in making that determination and the level of detail to be provided include:

- Circumstances specific to the entity (e.g., the differing nature of the entity's activities compared to those typical in the sector).
- Specific engagement circumstances affecting the nature and extent of the procedures performed.
- The intended users' expectations of the level of detail to be provided in the report, based on market practice, or applicable law or regulation.

A144. In describing the procedures performed in the limited assurance report, it is important that they are written in an objective way but are not summarized to the extent that they are ambiguous, nor written in a way that is overstated or embellished or that implies that reasonable assurance has been obtained. It is also important that the description of the procedures not give the impression that an agreed-upon procedures engagement has been undertaken, and in most cases will not detail the entire work plan.

The Practitioner's Signature (Ref: Para. 76(k))

A145. The practitioner's signature is either in the name of the practitioner's firm, the personal name of the practitioner, or both, as appropriate for the particular jurisdiction. In addition to the practitioner's signature, in certain jurisdictions, the practitioner may be required to declare in the assurance report the practitioner's professional designation or the fact that the practitioner or firm, as appropriate, has been recognized by the appropriate licensing authority in that jurisdiction.

Emphasis of Matter Paragraphs and Other Matter Paragraphs (Ref: Para. 77)

A146. A widespread use of Emphasis of Matter or Other Matter paragraphs diminishes the effectiveness of the practitioner's communication of such matters.

A147. An Emphasis of Matter paragraph may be appropriate when, for example, different criteria have been used or the criteria have been revised, updated or interpreted differently than in prior periods and this has had a fundamental effect on reported emissions, or a system breakdown for part of the period being accounted for means that extrapolation was used to estimate emissions for that time and this has been stated in the GHG statement.

A148. An Other Matter paragraph may be appropriate when, for example, the scope of the engagement has changed significantly from the prior period and this has not been stated in the GHG statement.

A149. The content of an Emphasis of Matter paragraph includes a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the GHG statement. It also indicates that the practitioner's conclusion is not modified in respect of the matter emphasized. (See also paragraph A125)

A150. The content of an Other Matter paragraph reflects clearly that such other matter is not required to be presented and disclosed in the GHG statement. Paragraph 77 limits the use of an Other Matter paragraph to matters relevant to users' understanding of the engagement, the practitioner's responsibilities or the assurance report, that the practitioner considers it necessary to communicate in the assurance report. (See also paragraph A124)

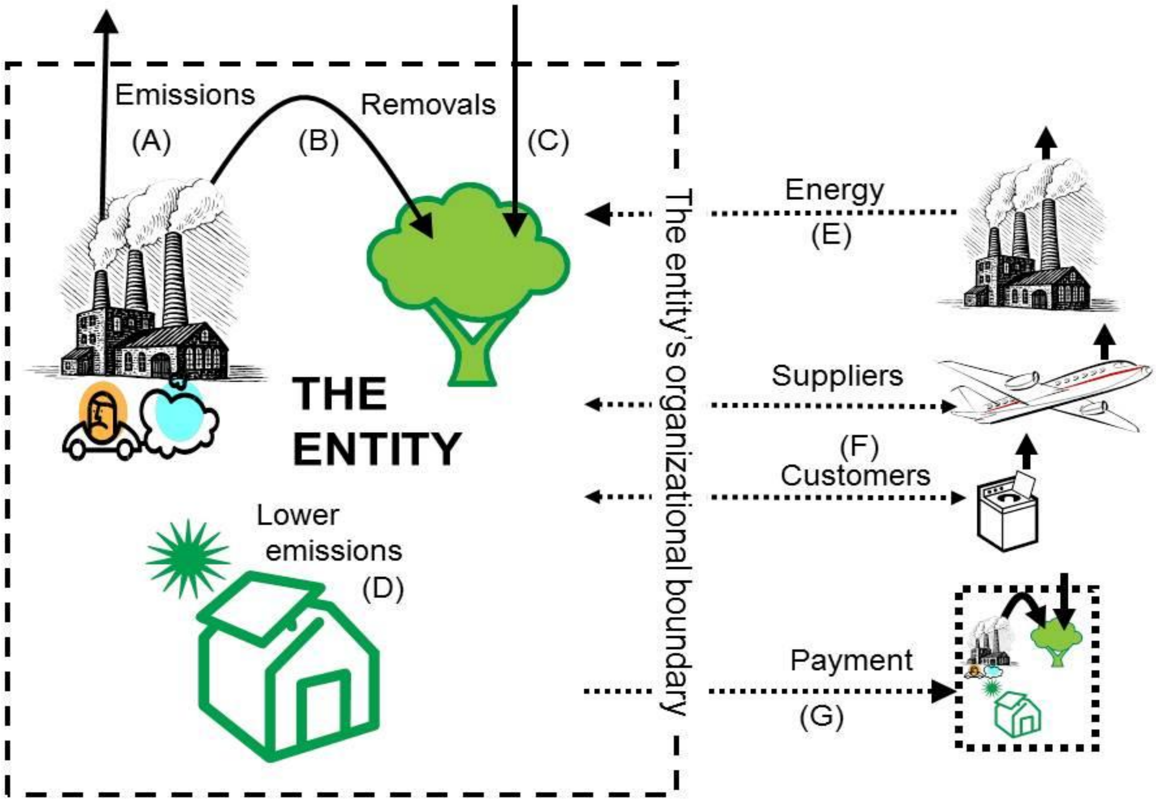
A151. Including the practitioner's recommendations on matters such as improvements to the entity's information system in the assurance report may imply that those matters have not been appropriately dealt with in preparing the GHG statement. Such recommendations may be communicated, for example, in a management letter or in discussion with those charged with governance. Considerations relevant to deciding whether to include recommendations in the assurance report include whether their nature is relevant to the information needs of intended users, and whether they are worded appropriately to ensure they will not be misunderstood as a qualification of the practitioner's conclusion on the GHG statement.

A152. An Other Matter paragraph does not include information that the practitioner 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.

Appendix 1

(Ref: Para. A8–A14)

Emissions, Removals and Emissions Deductions



A = Direct, or Scope 1, emissions (see paragraph A8).

B = Removals (emissions that are generated within the entity's boundary but captured and stored within that boundary rather than released into the atmosphere. They are commonly accounted for on a gross basis, that is, as a Scope 1 emission and a removal) (see paragraph A14).

C = Removals (GHGs the entity has removed from the atmosphere) (see paragraph A14).

D = Actions the entity takes to lower its emissions. Such actions might reduce Scope 1 emissions (for example, using more fuel efficient vehicles), Scope 2 emissions (for example, installing solar panels to reduce the quantity of purchased electricity), or Scope 3 emissions (for example, reducing business travel or selling products that require less energy to use). The entity might discuss such actions in the explanatory notes to the GHG statement, but they only affect the quantification of emissions on the face of the entity's GHG statement to the extent that reported emissions are lower than they would otherwise be or they constitute an emissions deduction in accordance with the applicable criteria (see paragraph A11).

E = Scope 2 emissions (see paragraph A9).

F = Scope 3 emissions (see paragraph A10).

G = Emissions deductions, including purchased offsets (see paragraphs A11–A13).

Appendix 2
(Ref: Para. A134)

Illustrations of Assurance Reports on GHG Statements

Illustration 1:

Circumstances include the following:

- **Reasonable assurance engagement.**
- **The entity's GHG statement contains no Scope 3 emissions.**
- **The entity's GHG statement contains no emissions deductions.**
- **The GHG statement contains no comparative information.**

The following illustrative report is for guidance only and is not intended to be exhaustive or applicable to all situations.

INDEPENDENT PRACTITIONER'S REASONABLE ASSURANCE REPORT ON ABC'S GREENHOUSE GAS (GHG) STATEMENT

[Appropriate Addressee]

Report on GHG Statement (*this heading is not needed if this is the only section*)

We have undertaken a reasonable assurance engagement of the accompanying GHG statement of ABC for the year ended 31 December 20X1, comprising the Emissions Inventory and the Explanatory Notes on pages xx–yy. [This engagement was conducted by a multidisciplinary team including assurance practitioners, engineers and environmental scientists.] [27]

ABC's Responsibility for the GHG Statement

ABC is responsible for the preparation of the GHG statement in accordance with [*applicable criteria*[28]], applied as explained in Note 1 to the GHG statement. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation of a GHG statement that is free from material misstatement, whether due to fraud or error.

[As discussed in Note 1 to the GHG statement,][29] GHG quantification is subject to inherent uncertainty because of incomplete scientific knowledge used to determine emissions factors and the values needed to combine emissions of different gases.

Our Independence and Quality Control

We have complied with the independence and other ethical requirements of the *Code of Ethics for Professional Accountants* issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

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27 The sentence should be deleted if it is not applicable to the engagement (for example, if the engagement was to report only on Scope 2 emissions and no other experts were used).

28 Information is available on the website of the Hong Kong Environmental Protection Department, in particular the "Guidelines to Account for and Report on Greenhouse Gas Emissions and Removals for Buildings (Commercial, Residential or Institutional Purposes) in Hong Kong" at www.epd.gov.hk/epd/english/climate_change/files/Guidelines_English_2010.pdf or the website of the Greenhouse Gas Protocol at www.ghgprotoco.org.

29 Where there is no discussion of the inherent uncertainty in Note 1 to the GHG statement, this should be deleted.

The firm applies Hong Kong Standard on Quality Control 1 [30] and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

Our Responsibility

Our responsibility is to express an opinion on the GHG statement based on the evidence we have obtained[30a]. We conducted our reasonable assurance engagement in accordance with Hong Kong Standard on Assurance Engagements 3410, *Assurance Engagements on Greenhouse Gas Statements* ("HKSAE 3410"), issued by the HKICPA. That standard requires that we plan and perform this engagement to obtain reasonable assurance about whether the GHG statement is free from material misstatement.

A reasonable assurance engagement in accordance with HKSAE 3410 involves performing procedures to obtain evidence about the quantification of emissions and related information in the GHG statement. The nature, timing and extent of procedures selected depend on the practitioner's judgment, including the assessment of the risks of material misstatement, whether due to fraud or error, in the GHG statement. In making those risk assessments, we considered internal control relevant to ABC's preparation of the GHG statement. A reasonable assurance engagement also includes:

- Assessing the suitability in the circumstances of ABC's use of [*applicable criteria*], applied as explained in Note 1 to the GHG statement, as the basis for preparing the GHG statement;
- Evaluating the appropriateness of quantification methods and reporting policies used, and the reasonableness of estimates made by ABC; and
- Evaluating the overall presentation of the GHG statement.

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

Opinion

In our opinion, the GHG statement for the year ended 31 December 20X1 is prepared, in all material respects, in accordance with the [*applicable criteria*] applied as explained in Note 1 to the GHG statement.

Report on Other Legal and Regulatory Requirements *(applicable for some engagements only)*

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

[Practitioner's signature]

[Date of the assurance report]

[Practitioner's address]

[30] HKSQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

[30a] Practitioners 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".

Illustration 2:

Circumstances include the following:

- **Limited assurance engagement.**
- **The entity's GHG statement contains no Scope 3 emissions.**
- **The entity's GHG statement contains no emissions deductions.**
- **The GHG statement contains no comparative information**

The following illustrative report is for guidance only and is not intended to be exhaustive or applicable to all situations.

INDEPENDENT PRACTITIONER'S LIMITED ASSURANCE REPORT ON ABC'S GREENHOUSE GAS (GHG) STATEMENT

[Appropriate Addressee]

Report on GHG Statement (*this heading is not needed if this is the only section*)

We have undertaken a limited assurance engagement of the accompanying GHG statement of ABC for the year ended 31 December 20X1, comprising the Emissions Inventory [and the Explanatory Notes on pages xx–yy]. [This engagement was conducted by a multidisciplinary team including assurance practitioners, engineers and environmental scientists.][31]

ABC's Responsibility for the GHG Statement

ABC is responsible for the preparation of the GHG statement in accordance with [*applicable criteria*[32]], applied as explained in Note 1 to the GHG statement. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation of a GHG statement that is free from material misstatement, whether due to fraud or error.

[As discussed in Note 1 to the GHG statement,][33] GHG quantification is subject to inherent uncertainty because of incomplete scientific knowledge used to determine emissions factors and the values needed to combine emissions of different gases.

Our Independence and Quality Control

We have complied with the independence and other ethical requirements of the *Code of Ethics for Professional Accountants* issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behavior.

[31] The sentence should be deleted if it is not applicable to the engagement (for example, if the engagement was to report only on Scope 2 emissions and no other experts were used).

[32] Information is available on the website of the Hong Kong Environmental Protection Department, in particular the "Guidelines to Account for and Report on Greenhouse Gas Emissions and Removals for Buildings (Commercial, Residential or Institutional Purposes) in Hong Kong" at www.epd.gov.hk/epd/english/climate_change/files/Guidelines_English_2010.pdf or the website of the Greenhouse Gas Protocol at www.ghgprotocol.org.

[33] Where there is no discussion of the inherent uncertainty in Note 1 to the GHG statement, this should be deleted.

The firm applies Hong Kong Standard on Quality Control 1 [34] and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

Our Responsibility

Our responsibility is to express a limited assurance conclusion on the GHG statement based on the procedures we have performed and the evidence we have obtained[34a]. We conducted our limited assurance engagement in accordance with Hong Kong Standard on Assurance Engagements 3410, *Assurance Engagements on Greenhouse Gas Statements* ("HKSAE 3410"), issued by the HKICPA. That standard requires that we plan and perform this engagement to obtain limited assurance about whether the GHG statement is free from material misstatement.

A limited assurance engagement undertaken in accordance with HKSAE 3410 involves assessing the suitability in the circumstances of ABC's use of [applicable criteria] as the basis for the preparation of the GHG statement, assessing the risks of material misstatement of the GHG statement whether due to fraud or error, responding to the assessed risks as necessary in the circumstances, and evaluating the overall presentation of the GHG statement. A limited assurance engagement is substantially less in scope than a reasonable assurance engagement in relation to both the risk assessment procedures, including an understanding of internal control, and the procedures performed in response to the assessed risks.

The procedures we performed were based on our professional judgment and included inquiries, observation of processes performed, inspection of documents, analytical procedures, evaluating the appropriateness of quantification methods and reporting policies, and agreeing or reconciling with underlying records.

> *[[The practitioner may insert a summary of the nature and extent of procedures performed that, in the practitioner's judgment, provides additional information that may be relevant to the users' understanding of the basis for the practitioner's conclusion.[35] The following section has been provided as guidance, and the example procedures are not an exhaustive list of either the type, or extent, of the procedures which may be important for the users' understanding of the work done.]*[36]
>
> Given the circumstances of the engagement, in performing the procedures listed above we:
>
> - Through inquiries, obtained an understanding of ABC's control environment and information systems relevant to emissions quantification and reporting, but did not evaluate the design of particular control activities, obtain evidence about their implementation or test their operating effectiveness.
> - Evaluated whether ABC's methods for developing estimates are appropriate and had been consistently applied. However, our procedures did not include testing the data on which the estimates are based or separately developing our own estimates against which to evaluate ABC's estimates.

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[34] HKSQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

[34a] Practitioners 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".

[35] *The procedures are to be summarized but not to the extent that they are ambiguous, nor described in a way that is overstated or embellished or that implies that reasonable assurance has been obtained. It is important that the description of the procedures does not give the impression that an agreed-upon procedures engagement has been undertaken, and in most cases will not detail the entire work plan.*

[36] In the final report, this explanatory paragraph will be deleted.

- Undertook site visits [at three sites] to assess the completeness of the emissions sources, data collection methods, source data and relevant assumptions applicable to the sites. The sites selected for testing were chosen taking into consideration their emissions in relation to total emissions, emissions sources, and sites selected in prior periods. Our procedures [did/did not] include testing information systems to collect and aggregate facility data, or the controls at these sites.][37]

The procedures performed in a limited assurance engagement vary in nature and timing from, and are less in extent than for, a reasonable assurance engagement. Consequently, the level of assurance obtained in a limited assurance engagement is substantially lower than the assurance that would have been obtained had we performed a reasonable assurance engagement. Accordingly, we do not express a reasonable assurance opinion about whether ABC's GHG statement has been prepared, in all material respects, in accordance with the [*applicable criteria*] applied as explained in Note 1 to the GHG statement.

Limited Assurance Conclusion

Based on the procedures we have performed and the evidence we have obtained, nothing has come to our attention that causes us to believe that ABC's GHG statement for the year ended 31 December 20X1 is not prepared, in all material respects, in accordance with the [*applicable criteria*] applied as explained in Note 1 to the GHG statement.

Report on Other Legal and Regulatory Requirements *(applicable for some engagements only)*

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

[Practitioner's signature]

[Date of the assurance report]

[Practitioner's address]

[37] This section should be deleted if the practitioner concludes that the expanded information on the procedures performed is not needed in the circumstances of the engagement.

HKSRS 4410 (Revised)
Revised July 2012, January 2019

Effective for compilation engagement
reports dated on or after 1 July 2013

Hong Kong Standard on Related Services 4410 (Revised)

Compilation Engagements

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

HONG KONG STANDARD ON RELATED SERVICES 4410 (REVISED)

COMPILATION ENGAGEMENTS

(Effective for compilation engagement reports dated on or after 1 July 2013)

CONTENTS

Hong Kong Standard on Related Services (HKSRS) 4410 (Revised), *Compilation Engagements*, should be read in conjunction with the *Preface to the Hong Kong Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements*.

Introduction

Scope of this HKSRS

1. This Hong Kong Standard on Related Services (HKSRS) deals with the practitioner's responsibilities when engaged to assist management with the preparation and presentation of historical financial information without obtaining any assurance on that information, and to report on the engagement in accordance with this HKSRS. (Ref: Para. A1–A2)

2. This HKSRS applies to compilation engagements for historical financial information. The HKSRS may be applied, adapted as necessary, to compilation engagements for financial information other than historical financial information, and to compilation engagements for non-financial information. Hereinafter in this HKSRS, reference to "financial information" means "historical financial information." (Ref: Para. A3–A4)

3. When the practitioner is requested to assist management with the preparation and presentation of financial information, appropriate consideration may need to be given to whether the engagement should be undertaken in accordance with this HKSRS. Factors that indicate that it may be appropriate to apply this HKSRS, including reporting under this HKSRS, include whether:

   - The financial information is required under provisions of applicable law or regulation, and whether it is required to be publicly filed.

   - External parties other than the intended users of the compiled financial information are likely to associate the practitioner with the financial information, and there is a risk that the level of the practitioner's involvement with the information may be misunderstood, for example:

     - If the financial information is intended for use by parties other than management or those charged with governance, or may be provided to, or obtained by, parties who are not the intended users of the information; and

     - If the practitioner's name is identified with the financial information. (Ref: Para. A5)

Relationship with HKSQC 1[1]

4. Quality control systems, policies and procedures are the responsibility of the firm. HKSQC 1 applies to firms of professional accountants in respect of a firm's compilation engagements.[2] The provisions of this HKSRS regarding quality control at the level of individual compilation engagements are premised on the basis that the firm is subject to HKSQC 1 or requirements that are at least as demanding. (Ref: Para. A6–A11)

The Compilation Engagement

5. Management may request a professional accountant in public practice to assist with the preparation and presentation of financial information of an entity. The value of a compilation engagement performed in accordance with this HKSRS to users of financial information results from the application of the practitioner's professional expertise in accounting and financial reporting and compliance with professional standards, including relevant ethical requirements, and the clear communication of the nature and extent of the practitioner's involvement with the compiled financial information. (Ref: Para. A12–A15)

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[1] Hong Kong Standard on Quality Control (HKSQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

[2] HKSQC 1, paragraph 4

6. Since a compilation engagement is not an assurance engagement, a compilation engagement does not require the practitioner to verify the accuracy or completeness of the information provided by management for the compilation, or otherwise to gather evidence to express an audit opinion or a review conclusion on the preparation of the financial information.

7. Management retains responsibility for the financial information and the basis on which it is prepared and presented. That responsibility includes application by management of the judgment required for the preparation and presentation of the financial information, including the selection and application of appropriate accounting policies and, where needed, developing reasonable accounting estimates. (Ref: Para. A12–A13)

8. This HKSRS does not impose responsibilities on management or those charged with governance, or override laws and regulations that govern their responsibilities. An engagement performed in accordance with this HKSRS is conducted on the premise that management, or those charged with governance where appropriate, have agreed certain responsibilities that are fundamental to the performance of the compilation engagement. (Ref: Para. A12–A13)

9. Financial information that is the subject of a compilation engagement may be required for various purposes including:

   (a) To comply with mandatory periodic financial reporting requirements established in law or regulation; or

   (b) For purposes unrelated to mandatory financial reporting under relevant law or regulation, including for example:

      - For management or those charged with governance, prepared on a basis appropriate for their particular purposes (such as preparation of financial information for internal use).

      - For periodic financial reporting undertaken for external parties under a contract or other form of agreement (such as financial information provided to a funding body to support provision or continuation of a grant).

      - For transactional purposes, for example to support a transaction involving changes to the entity's ownership or financing structure (such as for a merger or acquisition).

10. Different financial reporting frameworks can be used to prepare and present financial information, ranging from a simple entity-specific basis of accounting to established financial reporting standards. The financial reporting framework adopted by management to prepare and present the financial information will depend on the nature of the entity and the intended use of the information. (Ref: Para. A16–A18)

Authority of this HKSRS

11. This HKSRS contains the objectives of the practitioner in following the HKSRS which provide the context in which the requirements of this HKSRS are set, and are intended to assist the practitioner in understanding what needs to be accomplished in a compilation engagement.

12. This HKSRS contains requirements, expressed using "shall," that are designed to enable the practitioner to meet the stated objectives.

13. In addition, this HKSRS contains introductory material, definitions, and application and other explanatory material, that provide context relevant to a proper understanding of the HKSRS.

14. The application and other explanatory material provides further explanation of the requirements and guidance for carrying them out. While such guidance does not in itself

impose a requirement, it is relevant to the proper application of the requirements. The application and other explanatory material may also provide background information on matters addressed in this HKSRS that assists in the application of the requirements.

Effective Date

15. This HKSRS is effective for compilation engagement reports dated on or after 1 July 2013.

Objectives

16. The practitioner's objectives in a compilation engagement under this HKSRS are to:

(a) Apply accounting and financial reporting expertise to assist management in the preparation and presentation of financial information in accordance with an applicable financial reporting framework based on information provided by management; and

(b) Report in accordance with the requirements of this HKSRS.

Definitions

17. The Members' Handbook's Glossary of Terms[3] (the Glossary) includes the terms defined in this HKSRS and also includes descriptions of other terms found in this HKSRS, to assist in consistent interpretation. The following terms have the meanings attributed below for the purposes of this HKSRS:

(a) *Applicable financial reporting framework* – The financial reporting framework adopted by management and, where appropriate, those charged with governance in the preparation of the financial information that is acceptable in view of the nature of the entity and the objective of the financial information, or that is required by law or regulation. (Ref: Para. A30–A32)

(b) *Compilation engagement* – An engagement in which a practitioner applies accounting and financial reporting expertise to assist management in the preparation and presentation of financial information of an entity in accordance with an applicable financial reporting framework, and reports as required by this HKSRS. Throughout this HKSRS, the words "compile", "compiling" and "compiled" are used in this context.

(c) *Engagement partner* – The partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.

(d) *Engagement team* – All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform procedures on the engagement. This excludes external experts engaged by the firm or a network firm.

(e) *Misstatement* – A difference between the amount, classification, presentation, or disclosure of a reported item in the financial information, and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud.

Where the financial information is prepared in accordance with a fair presentation framework, misstatements also include those adjustments of amounts, classifications, presentation, or disclosures that, in the practitioner's judgment, are necessary for the

[3] The Glossary of Terms Relating to Hong Kong Standards on Quality Control, Auditing, Review, Other Assurance and Related Services issued by the HKICPA in Volume III of the Members' Handbook

financial information to be presented fairly, in all material respects, or to give a true and fair view.

(f) *Practitioner* – A professional accountant in public practice who conducts the compilation engagement. The term includes the engagement partner or other members of the engagement team, or, as applicable, the firm. Where this HKSRS expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the term "engagement partner" rather than "practitioner" is used. "Engagement partner" and "firm" are to be read as referring to their public sector equivalents where relevant.

(g) *Relevant ethical requirements* – Ethical requirements the engagement team is subject to when undertaking compilation engagements. These requirements ordinarily comprise Parts A, B and D of the HKICPA's *Code of Ethics for Professional Accountants* (the Code) (excluding Section 290*, Independence—Audit and Review Engagements*, and Section 291, *Independence—Other Assurance Engagements* in Part B), together with local requirements that are more restrictive. (Ref: Para. A21)

Requirements

Conduct of a Compilation Engagement in Accordance with this HKSRS

18. The practitioner shall have an understanding of the entire text of this HKSRS, including its application and other explanatory material, to understand its objectives and to apply its requirements properly.

Complying with Relevant Requirements

19. The practitioner shall comply with each requirement of this HKSRS unless a particular requirement is not relevant to the compilation engagement, for example if the circumstances addressed by the requirement do not exist in the engagement.

20. The practitioner shall not represent compliance with this HKSRS unless the practitioner has complied with all requirements of this HKSRS relevant to the compilation engagement.

Ethical Requirements

21. The practitioner shall comply with relevant ethical requirements. (Ref: Para. A19–A26)

Professional Judgment

22. The practitioner shall exercise professional judgment in conducting a compilation engagement. (Ref: Para. A27–A29)

Engagement Level Quality Control

23. The engagement partner shall take responsibility for:

    (a) The overall quality of each compilation engagement to which that partner is assigned; and

    (b) The engagement being performed in accordance with the firm's quality control policies and procedures, by: (Ref: Para. A30)

        (i) Following appropriate procedures regarding the acceptance and continuance of client relationships and engagements; (Ref: Para. A31)

(ii) Being satisfied that the engagement team collectively has the appropriate competence and capabilities to perform the compilation engagement;

(iii) Being alert for indications of non-compliance by members of the engagement team with relevant ethical requirements, and determining the appropriate action if matters come to the engagement partner's attention indicating that members of the engagement team have not complied with relevant ethical requirements; (Ref: Para. A32)

(iv) Directing, supervising and performing the engagement in compliance with professional standards and applicable legal and regulatory requirements; and

(v) Taking responsibility for appropriate engagement documentation being maintained.

Engagement Acceptance and Continuance

Continuance of Client Relationships, Engagement Acceptance and Agreeing the Terms of the Engagement

24. The practitioner shall not accept the engagement unless the practitioner has agreed the terms of engagement with management, and the engaging party if different, including:

(a) The intended use and distribution of the financial information, and any restrictions on either its use or its distribution where applicable; (Ref: Para. A20, A33–A34, A37–A38)

(b) Identification of the applicable financial reporting framework; (Ref: Para. A20, A35–A38)

(c) The objective and scope of the compilation engagement; (Ref: Para. A20)

(d) The responsibilities of the practitioner, including the requirement to comply with relevant ethical requirements; (Ref: Para. A20)

(e) The responsibilities of management for: (Ref: Para. A39–A41)

(i) The financial information, and for the preparation and presentation thereof, in accordance with a financial reporting framework that is acceptable in view of the intended use of the financial information and the intended users;

(ii) The accuracy and completeness of the records, documents, explanations and other information provided by management for the compilation engagement; and

(iii) Judgments needed in the preparation and presentation of the financial information, including those for which the practitioner may provide assistance in the course of the compilation engagement; and (Ref: Para. A27)

(f) The expected form and content of the practitioner's report.

25. The practitioner shall record the agreed terms of engagement in an engagement letter or other suitable form of written agreement, prior to performing the engagement. (Ref: Para. A42–A44)

Recurring Engagements

26. On recurring compilation engagements, the practitioner shall evaluate whether circumstances, including changes in the engagement acceptance considerations, require the terms of engagement to be revised and whether there is need to remind management of the existing terms of engagement. (Ref: Para. A45)

Communication with Management and Those Charged with Governance

27. The practitioner shall communicate with management or those charged with governance, as appropriate, on a timely basis during the course of the compilation engagement, all matters concerning the compilation engagement that, in the practitioner's professional judgment, are of sufficient importance to merit the attention of management or those charged with governance, as appropriate. (Ref: Para. A46-A47)

Performing the Engagement

The Practitioner's Understanding

28. The practitioner shall obtain an understanding of the following matters sufficient to be able to perform the compilation engagement: (Ref: Para. A48–A50)

    (a) The entity's business and operations, including the entity's accounting system and accounting records; and

    (b) The applicable financial reporting framework, including its application in the entity's industry.

Compiling the Financial Information

29. The practitioner shall compile the financial information using the records, documents, explanations and other information, including significant judgments, provided by management.

30. The practitioner shall discuss with management, or those charged with governance as appropriate, those significant judgments, for which the practitioner has provided assistance in the course of compiling the financial information. (Ref: Para. A51)

31. Prior to completion of the compilation engagement, the practitioner shall read the compiled financial information in light of the practitioner's understanding of the entity's business and operations, and of the applicable financial reporting framework. (Ref: Para. A52)

32. If, in the course of the compilation engagement, the practitioner becomes aware that the records, documents, explanations or other information, including significant judgments, provided by management for the compilation engagement are incomplete, inaccurate or otherwise unsatisfactory, the practitioner shall bring that to the attention of management and request the additional or corrected information.

33. If the practitioner is unable to complete the engagement because management has failed to provide records, documents, explanations or other information, including significant judgments, as requested, the practitioner shall withdraw from the engagement and inform management and those charged with governance of the reasons for withdrawing. (Ref: Para. A58)

34. If the practitioner becomes aware during the course of the engagement that:

   (a) The compiled financial information does not adequately refer to or describe the applicable financial reporting framework; (Ref: Para. A53)

   (b) Amendments to the compiled financial information are required for the financial information not to be materially misstated; or (Ref: Para. A54–A56)

   (c) The compiled financial information is otherwise misleading, (Ref: Para. A57)

   the practitioner shall propose the appropriate amendments to management.

35. If management declines, or does not permit the practitioner to make the proposed amendments to the compiled financial information, the practitioner shall withdraw from the engagement and inform management and those charged with governance of the reasons for withdrawing. (Ref: Para. A58)

36. If withdrawal from the engagement is not possible, the practitioner shall determine the professional and legal responsibilities applicable in the circumstances.

37. The practitioner shall obtain an acknowledgement from management or those charged with governance, as appropriate, that they have taken responsibility for the final version of the compiled financial information. (Ref: Para. A68)

Documentation

38. The practitioner shall include in the engagement documentation: (Ref: Para. A59–A61)

   (a) Significant matters arising during the compilation engagement and how those matters were addressed by the practitioner;

   (b) A record of how the compiled financial information reconciles with the underlying records, documents, explanations and other information, provided by management; and

   (c) A copy of the final version of the compiled financial information for which management or those charged with governance, as appropriate, has acknowledged their responsibility, and the practitioner's report. (Ref: Para. A68)

The Practitioner's Report

39. An important purpose of the practitioner's report is to clearly communicate the nature of the compilation engagement, and the practitioner's role and responsibilities in the engagement. The practitioner's report is not a vehicle to express an opinion or conclusion on the financial information in any form.

40. The practitioner's report issued for the compilation engagement shall be in writing, and shall include the following elements: (Ref: Para. A62–A63, A69)

   (a) The report title;

   (b) The addressee(s), as required by the terms of the engagement; (Ref: Para. A64)

   (c) A statement that the practitioner has compiled the financial information based on information provided by management;

   (d) A description of the responsibilities of management, or those charged with governance as appropriate, in relation to the compilation engagement, and in relation to the financial information;

(e) Identification of the applicable financial reporting framework and, if a special purpose financial reporting framework is used, a description or reference to the description of that special purpose financial reporting framework in the financial information;

(f) Identification of the financial information, including the title of each element of the financial information if it comprises more than one element, and the date of the financial information or the period to which it relates;

(g) A description of the practitioner's responsibilities in compiling the financial information, including that the engagement was performed in accordance with this HKSRS, and that the practitioner has complied with relevant ethical requirements;

(h) A description of what a compilation engagement entails in accordance with this HKSRS;

(i) Explanations that:

(i) Since a compilation engagement is not an assurance engagement, the practitioner is not required to verify the accuracy or completeness of the information provided by management for the compilation,; and

(ii) Accordingly, the practitioner does not express an audit opinion or a review conclusion on whether the financial information is prepared in accordance with the applicable financial reporting framework.

(j) If the financial information is prepared using a special purpose financial reporting framework, an explanatory paragraph that: (Ref: Para. A65–A67)

(i) Describes the purpose for which the financial information is prepared and, if necessary, the intended users, or contains a reference to a note in the financial information that discloses this information; and

(ii) Draws the attention of readers of the report to the fact that the financial information is prepared in accordance with a special purpose framework and that, as a result, the information may not be suitable for other purposes;

(k) The date of the practitioner's report;

(l) The practitioner's signature; and

(m) The practitioner's address.

41. The practitioner shall date the report on the date the practitioner has completed the compilation engagement in accordance with this HKSRS. (Ref: Para. A68)

Conformity and Compliance with International Standards on Related Services

42. As of July 2012 *(date of issue)*, this HKSRS conforms with International Standard on Related Services (ISRS) 4410 (Revised), "Compilation Engagements" except that references to IFAC Code of Ethics for Professional Accountants are replaced by HKICPA's Code of Ethics for Professional Accountants. With the exception of the foregoing difference, compliance with the requirements of this HKSRS ensures compliance with ISRS 4410 (Revised).

43. Additional local guidance is provided in footnote 8a, footnote 9a of Appendix 1 and footnotes 9b, 9c, 10a, 10b and 11a of Appendix 2.

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Application and Other Explanatory Material

Scope of this HKSRS

General Considerations (Ref: Para. 1)

A1. In a compilation engagement where the engaging party is someone other than management or those charged with governance of the entity, this HKSRS may be applied adapted as necessary.

A2. A practitioner's involvement with services or activities in the course of assisting management of an entity with the preparation and presentation of the entity's financial information can take many different forms. When the practitioner is engaged to provide such services or activities for an entity under this HKSRS, the practitioner's association with the financial information is communicated through the practitioner's report provided for the engagement in the form required by this HKSRS. The practitioner's report contains the practitioner's explicit assertion of compliance with this HKSRS.

Application to Compilation Engagements Other than for Historical Financial Information (Ref: Para. 2)

A3. This HKSRS addresses engagements where the practitioner assists management in the preparation and presentation of historical financial information. The HKSRS may, however, also be applied, adapted as necessary, when the practitioner is engaged to assist management in preparing and presenting other financial information. Examples include:

- Pro forma financial information.
- Prospective financial information, including financial budgets or forecasts.

A4. Practitioners may also undertake engagements to assist management in the preparation and presentation of non-financial information, for example, greenhouse gas statements, statistical returns or other information returns. In those circumstances, the practitioner may apply this HKSRS, adapted as necessary, as relevant to those types of engagements.

Considerations Relevant to Application of the HKSRS (Ref: Para. 3)

A5. Mandatory application of this HKSRS may be specified in local settings for engagements where practitioners undertake services relevant to the preparation and presentation of financial information of an entity (such as in relation to preparation of historical financial statements required for public filing). If mandatory application is not specified, either under law or regulation, or under applicable professional standards or otherwise, the practitioner may nevertheless conclude that applying this HKSRS is appropriate in the circumstances.

Relationship with HKSQC 1 (Ref: Para. 4)

A6. HKSQC 1 deals with the firm's responsibilities to establish and maintain its system of quality control for related services engagements, including compilation engagements. Those responsibilities are directed at establishing:

- The firm's quality control system; and
- The firm's related policies designed to achieve the objective of the quality control system and its procedures to implement and monitor compliance with those policies.

A7. Under HKSQC 1, the firm has an obligation to establish and maintain a system of quality control to provide it with reasonable assurance that:

(a) The firm and its personnel comply with professional standards and applicable legal and regulatory requirements; and

(b) Reports issued by the firm or engagement partners are appropriate in the circumstances.[4]

A8. A jurisdiction that has not adopted HKSQC 1 in relation to compilation engagements may set out requirements for quality control in firms performing such engagements. The provisions of this HKSRS regarding quality control at the engagement level are premised on the basis that quality control requirements adopted are at least as demanding as those of HKSQC 1. This is achieved when those requirements impose obligations on the firm to achieve the aims of the requirements of HKSQC 1, including an obligation to establish a system of quality control that includes policies and procedures that address each of the following elements:

- Leadership responsibilities for quality within the firm;
- Relevant ethical requirements;
- Acceptance and continuance of client relationships and specific engagements;
- Human resources;
- Engagement performance; and
- Monitoring.

A9. Within the context of the firm's system of quality control, engagement teams have a responsibility to implement quality control procedures applicable to the engagement.

A10. Unless information provided by the firm or other parties suggests otherwise, the engagement team is entitled to rely on the firm's system of quality control. For example, the engagement team may rely on the firm's system of quality control in relation to:

- Competence of personnel through their recruitment and formal training.
- Maintenance of client relationships through acceptance and continuance systems.
- Adherence to legal and regulatory requirements through the monitoring process.

In considering deficiencies identified in the firm's system of quality control that may affect the compilation engagement, the engagement partner may consider measures taken by the firm to rectify the situation that the engagement partner considers are sufficient in the context of that compilation engagement.

A11. A deficiency in the firm's system of quality control does not necessarily indicate that a compilation engagement was not performed in accordance with professional standards and applicable legal and regulatory requirements, or that the practitioner's report was not appropriate.

4 HKSQC 1, paragraph 11

The Compilation Engagement

Use of the Terms "Management" and "Those Charged with Governance" (Ref: Para. 5, 7–8)

A12. The respective responsibilities of management and those charged with governance will differ between jurisdictions, and between entities of various types. These differences affect the way the practitioner applies the requirements of this HKSRS regarding management or those charged with governance. Accordingly, the phrase "management and, where appropriate, those charged with governance" used in various places throughout this HKSRS is intended to alert the practitioner to the fact that different entity environments may have different management and governance structures and arrangements.

A13. Various responsibilities relating to the preparation of financial information and external financial reporting fall to either management or those charged with governance according to factors such as:

- The resources and structure of the entity.
- The respective roles of management and those charged with governance within the entity as set out in relevant law or regulation or, if the entity is not regulated, in any formal governance or accountability arrangements established for the entity (for example, as recorded in contracts, or a constitution or other type of document by which an entity is established).

In many small entities, there is often no separation of the management and governance roles for the entity, or those charged with governance of the entity may also be involved in managing the entity. In most other cases, especially in larger entities, management is responsible for execution of the business or activities of the entity and reporting thereon, while those charged with governance have oversight of management. In larger entities, those charged with governance will often have or assume responsibility for approving the financial information of the entity, particularly when it is intended for use by external parties. In large entities, often a subgroup of those charged with governance, such as an audit committee, is charged with certain oversight responsibilities. In some jurisdictions, the preparation of financial statements for an entity in accordance with a specified framework is the legal responsibility of those charged with governance, and in other jurisdictions it is a management responsibility.

Involvement in Other Activities Relating to Preparation and Presentation of Financial Information (Ref: Para. 5)

A14. The scope of a compilation engagement will vary depending on the circumstances of the engagement. However, in every case it will involve assisting management in the preparation and presentation of the entity's financial information in accordance with the financial reporting framework, based on information provided by management. In some compilation engagements, management may have already prepared the financial information itself in a draft or preliminary form.

A15. A practitioner may also be engaged to undertake certain other activities on behalf of management, additional to the compilation engagement. For example, the practitioner may be requested to also collect, classify and summarize the underlying accounting data of the entity and process the data in the form of accounting records through to production of a trial balance. The trial balance would then be used as the underlying information from which the practitioner can compile the financial information that is the subject of a compilation engagement undertaken in accordance with this HKSRS. This is often the case for smaller entities that do not have well-developed accounting systems, or entities that prefer to outsource the preparation of accounting records to external providers. This HKSRS does not address such additional activities that the practitioner may perform to assist management in other areas, in advance of compiling the entity's financial statements.

Financial Reporting Frameworks (Ref: Para. 10)

A16. The financial information may be prepared in accordance with a financial reporting framework designed to meet:

- The common financial information needs of a wide range of users (that is, a "general purpose financial reporting framework"); or
- The financial information needs of specific users (that is, a "special purpose financial reporting framework").

The requirements of the applicable financial reporting framework determine the form and content of the financial information. The financial reporting framework may, in some cases, be referred to as the "basis of accounting."

A17. Examples of commonly used general purpose financial reporting frameworks are:

- Hong Kong Financial Reporting Standards (HKFRS).
- International Financial Reporting Standards (IFRS).
- Hong Kong Financial Reporting Standards for Private Entities (HKFRS-PE).
- Hong Kong Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard (SME-FRF & SME-FRS).
- International Financial Reporting Standards for Small- and Medium-Sized Entities (IFRS for SMEs).

A18. Examples of special purpose financial reporting frameworks that may be used, depending on the particular purpose of the financial information, are:

- The tax basis of accounting used in a particular jurisdiction to prepare financial information to fulfill tax compliance obligations.
- For entities not required to use an established financial reporting framework:
  - A basis of accounting used in the financial information of a particular entity that is appropriate for the intended use of the financial information and the entity's circumstances (for example, use of the cash basis of accounting with selected accruals, such as accounts receivable and accounts payable, leading to a balance sheet and income statement; or use of an established financial reporting framework that is modified to suit the particular purpose for which the financial information is prepared).
  - The cash basis of accounting leading to a statement of receipts and disbursements (for example, for the purpose of allocating the excess of cash receipts over disbursements to the owners of a rental property; or to record movements in the petty cash fund of a club).

Ethical Requirements (Ref: Para. 21)

A19. Part A of the Code establishes the fundamental principles of professional ethics that practitioners must comply with, and provides a conceptual framework for applying those principles. The fundamental principles are:

(a) Integrity;

(b) Objectivity;

(c) Professional competence and due care;

(d) Confidentiality; and

(e) Professional behavior.

Part B of the Code illustrates how the conceptual framework is to be applied in specific situations. In complying with the Code, threats to the practitioner's compliance with relevant ethical requirements are required to be identified and appropriately addressed.

Ethical Considerations Regarding the Practitioner's Association with Information (Ref: Para. 21, 24(a)–(d))

A20. Under the Code,[5] in applying the principle of integrity, a professional accountant is required to not knowingly be associated with reports, returns, communications or other information where the professional accountant believes that the information:

(a) Contains a materially false or misleading statement;

(b) Contains statements or information furnished recklessly; or

(c) Omits or obscures information required to be included where such omission or obscurity would be misleading.

When a professional accountant becomes aware that the accountant has been associated with such information, the accountant is required by the Code to take steps to be disassociated from that information.

Independence (Ref: Para. 17(g), 21)

A21. Notwithstanding that Section 290, *Independence—Audit and Review Engagements* and Section 291, *Independence—Other Assurance Engagements* in Part B of the Code do not apply to compilation engagements, local ethical codes or laws or regulations may specify requirements or disclosure rules pertaining to independence.

Reporting of Identified or Suspected Non-Compliance with Laws and Regulations to an Appropriate Authority outside the Entity

A22. Law, regulation or relevant ethical requirements may:

(a) Require the practitioner to report identified or suspected non-compliance with laws and regulations to an appropriate authority outside the entity.

(b) Establish responsibilities under which reporting to an appropriate authority outside the entity may be appropriate in the circumstances.[6]

A23. Reporting identified or suspected non-compliance with laws and regulations to an appropriate authority outside the entity may be required or appropriate in the circumstances because:

(a) Law, regulation or relevant ethical requirements require the practitioner to report;

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[5] The Code Part A, paragraph 110.2

[6] See, for example, Sections 225.51-225.52 of the Code.

(b) The practitioner has determined reporting is an appropriate action to respond to identified or suspected non-compliance in accordance with relevant ethical requirements; or

(c) Law, regulation or relevant ethical requirements provide the practitioner with the right to do so.

A24. Under paragraph 28 of this HKSRS, the practitioner is not expected to have a level of understanding of laws and regulations beyond that necessary to be able to perform the compilation engagement. However, law, regulation or relevant ethical requirements may expect the practitioner to apply knowledge, professional judgment and expertise in responding to identified or suspected non-compliance. Whether an act constitutes actual non-compliance is ultimately a matter to be determined by a court or other appropriate adjudicative body.

A25. In some circumstances, the reporting of identified or suspected non-compliance with laws and regulations to an appropriate authority outside the entity may be precluded by the practitioner's duty of confidentiality under law, regulation or relevant ethical requirements. In other cases, reporting identified or suspected non-compliance to an appropriate authority outside the entity would not be considered a breach of the duty of confidentiality under the relevant ethical requirements.[7]

A26. The practitioner may consider consulting internally (e.g., within the firm or network firm), obtaining legal advice to understand the professional or legal implications of taking any particular course of action, or consulting on a confidential basis with a regulator or a professional body (unless doing so is prohibited by law or regulations or would breach the duty of confidentiality).[8]

Professional Judgment (Ref: Para. 22, 24(e)(iii))

A27. Professional judgment is essential to the proper conduct of a compilation engagement. This is because interpretation of relevant ethical requirements and the requirements of this HKSRS, and the need for informed decisions throughout the performance of a compilation engagement, require the application of relevant knowledge and experience to the facts and circumstances of the engagement. Professional judgment is necessary, in particular, when the engagement involves assisting management of the entity regarding decisions about:

- The acceptability of the financial reporting framework that is to be used to prepare and present the financial information of the entity, in view of the intended use of the financial information and the intended users thereof.

- The application of the applicable financial reporting framework, including:

    - Selection of appropriate accounting policies under that framework;

[7] See, for example, Section 140.7 and Section 225.53 of the Code.

[8] See, for example, Section 225.55 of the Code.

- ○ Development of accounting estimates needed for the financial information to be prepared and presented under that framework; and

- ○ Preparation and presentation of financial information in accordance with the applicable financial reporting framework.

The practitioner's assistance to management is always provided on the basis that management or those charged with governance, as appropriate, understand the significant judgments that are reflected in the financial information, and accept responsibility for those judgments.

A28. Professional judgment involves the application of relevant training, knowledge and experience, within the context provided by this HKSRS and accounting and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the compilation engagement.

A29. The exercise of professional judgment in individual engagements is based on the facts and circumstances that are known to the practitioner up to the date of the practitioner's report on the engagement, including:

- Knowledge acquired from performance of other engagements undertaken for the entity, where applicable (for example, taxation services).

- The practitioner's understanding of the entity's business and operations, including its accounting system, and of the application of the applicable financial reporting framework in the industry in which the entity operates.

- The extent to which the preparation and presentation of the financial information requires the exercise of management judgment.

Engagement Level Quality Control (Ref: Para. 23(b))

A30. The actions of the engagement partner and appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality on each engagement, emphasize the importance to achieving the quality of the engagement of:

(a) Performing work that complies with professional standards and regulatory and legal requirements;

(b) Complying with the firm's quality control policies and procedures as applicable; and

(c) Issuing the practitioner's report for the engagement in accordance with this HKSRS.

Acceptance and Continuance of Client Relationships and Compilation Engagements (Ref: Para. 23(b)(i))

A31. HKSQC 1 requires the firm to obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. Information that assists the engagement partner in determining whether acceptance or continuance of client relationships and compilation engagements is appropriate may include information concerning the integrity of the principal owners, key management and those charged with governance. If the engagement partner has cause to doubt management's integrity to a degree that is likely to affect proper performance of the engagement, it may not be appropriate to accept the engagement.

Compliance with Relevant Ethical Requirements in Conducting the Engagement (Ref: Para. 23(b)(iii))

A32. HKSQC 1 sets out the responsibilities of the firm for establishing policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements. This HKSRS sets out the engagement partner's responsibilities with respect to the engagement team's compliance with relevant ethical requirements.

Engagement Acceptance and Continuance

Identifying the Intended Use of the Financial Information (Ref: Para. 24(a))

A33. The intended use of the financial information is identified with reference to applicable law, regulation, or other arrangements established concerning the provision of financial information of the entity, bearing in mind the financial information needs of parties internal or external to the entity who are the intended users. Examples are financial information required to be provided by an entity in connection with undertaking transactions or financing applications with external parties such as suppliers, banks or other providers of finance or funding.

A34. The practitioner's identification of the intended use of the financial information also involves understanding such factors as the particular purpose(s) of management, or those charged with governance, where applicable, that are intended to be served through requesting the compilation engagement, and those of the engaging party where different. For example, a grant funding body may require the entity to provide financial information compiled by a professional accountant to obtain information about certain aspects of an entity's operations or activities, prepared in a specified form, to support provision of a grant or continuation of an existing grant.

Identification of the Applicable Financial Reporting Framework (Ref: Para. 17(a), 24(b))

A35. The decision about the financial reporting framework that management adopts for the financial information is made in the context of the intended use of the information as described in the agreed terms of engagement, and the requirements of any applicable law or regulation.

A36. The following are examples of factors that indicate it may be relevant to consider whether the financial reporting framework is acceptable:

- The nature of the entity, and whether it is a regulated form of entity, for example, whether it is a profit-oriented business enterprise, a public sector entity or a not-for-profit organization.

- The intended use of the financial information and the intended users. For example, the financial information could be intended to be used by a wide range of users or, alternatively, could be for use by management or by certain external users in the context of a particular purpose specified as part of agreeing the terms of the compilation engagement.

- Whether the applicable financial reporting framework is prescribed or specified, either in applicable law or regulation, or in a contract or other form of agreement with a third party, or as part of governance or accountability arrangements adopted voluntarily by the entity.

- The nature and form of the financial information that is to be prepared and presented under the applicable financial reporting framework, for example, a complete set of financial statements, a single financial statement, or financial information presented in another format agreed between parties to a contract or other form of agreement.

Relevant Factors When Financial Information Is Intended for a Particular Purpose (Ref: Para. 24(a) – (b))

A37. The engaging party generally agrees the nature and form of financial information that is intended for a particular purpose with the intended users, for example as specified under the financial reporting provisions of a contract or a project grant or as needed to support the entity's transactions or activities. The relevant contract may require use of an established financial reporting framework, such as a general purpose financial reporting framework established by an authorized or recognized standard-setting body or by law or regulation. Alternatively, the parties to the contract may agree on the use of a general purpose framework with modifications or adaptions that fit their particular needs. In that case, the applicable financial reporting framework may be described in the financial information and in the practitioner's report as being the financial reporting provisions of the specified contract rather than with reference to the modified financial reporting framework. In such cases, notwithstanding that the compiled financial information may be made more broadly available, the applicable financial reporting framework is a special purpose framework, and the practitioner is required to comply with the relevant reporting requirements of this HKSRS.

A38. When the applicable financial reporting framework is a special purpose financial reporting framework, the practitioner is required by this HKSRS to record any restrictions on either the intended use or distribution of the financial information in the engagement letter, and to state in the practitioner's report that the financial information is prepared using a special purpose financial reporting framework, and as a result may not be suitable for other purposes.

Responsibilities of Management (Ref: Para. (24(e))

A39. Under this HKSRS, the practitioner is required to obtain the agreement of management, or where applicable those charged with governance, on management's responsibilities in relation to both the financial information and the compilation engagement as a condition precedent to accepting the engagement. In smaller entities, management, or those charged with governance where applicable, may not be well-informed about what those responsibilities are, including those arising in applicable law or regulation. In order to obtain management's agreement on an informed basis, the practitioner may find it necessary to discuss those responsibilities with management in advance of seeking management's agreement on its responsibilities.

A40. If management does not acknowledge its responsibilities in the context of a compilation engagement, the practitioner is not able to undertake the engagement, and it is not appropriate for the practitioner to accept the engagement unless required to do so under applicable law or regulation. In circumstances where the practitioner is nevertheless required to accept the engagement, the practitioner may need to communicate with management about the importance of these matters and the implications for the engagement.

A41. The practitioner is entitled to rely on management to provide all relevant information for the compilation engagement on an accurate, complete and timely basis. The form of the information provided by management for the purpose of the engagement will vary in different engagement circumstances. In broad terms, it will comprise records, documents, explanations and other information relevant to the compilation of the financial information using the applicable financial reporting framework. The information provided may include, for example, information about management assumptions, intentions or plans underlying development of accounting estimates needed to compile the information under the applicable financial reporting framework.

Engagement Letter or Other Form of Written Agreement (Ref: Para. 25)

A42. It is in the interests of both management, and the engaging parties where different, and the practitioner that the practitioner sends an engagement letter to management and, where applicable, to the engaging parties prior to performing the compilation engagement, to help avoid misunderstandings with respect to the compilation engagement. An engagement letter confirms the practitioner's acceptance of the engagement and confirms such matters as:

- The objectives and scope of the engagement, including the understanding of the parties to the engagement that the engagement is not an assurance engagement.
- The intended use and distribution of the financial information, and any restrictions on its use or distribution (where applicable).
- The responsibilities of management in relation to the compilation engagement.
- The extent of the practitioner's responsibilities, including that the practitioner will not express an audit opinion or a review conclusion on the financial information.
- The form and content of the report to be issued by the practitioner for the engagement.

Form and Content of the Engagement Letter

A43. The form and content of the engagement letter may vary for each engagement. In addition to the matters required by this HKSRS, an engagement letter may make reference to, for example:

- Arrangements concerning the involvement of other practitioners and experts in some aspects of the compilation engagement.
- Arrangements to be made with the predecessor practitioner, if any, in the case of an initial engagement.
- The possibility that management or those charged with governance, as appropriate, may be requested to confirm in writing certain information or explanations conveyed orally to the practitioner during the engagement.
- Ownership of the information used for purposes of the compilation engagement, distinguishing between documents and information of the entity provided for the engagement and the practitioner's engagement documentation, having regard to applicable law and regulation.
- A request for management, and the engaging party if different, to acknowledge receipt of the engagement letter and to agree to the terms of the engagement outlined therein.

Illustrative Engagement Letter

A44. An illustrative engagement letter for a compilation engagement is set out in Appendix 1 to this HKSRS.

Recurring Engagements (Ref: Para. 26)

A45. The practitioner may decide not to send a new engagement letter or other written agreement each period. However, the following factors may indicate that it is appropriate to revise the terms of the compilation engagement, or to remind management or the engaging party, where applicable, of the existing terms of the engagement:

- Any indication that management or the engaging party, where applicable, misunderstands the objective and scope of the engagement.
- Any revised or special terms of the engagement.

- A recent change of senior management of the entity.
- A significant change in ownership of the entity.
- A significant change in nature or size of the entity's business.
- A change in legal or regulatory requirements affecting the entity.
- A change in the applicable financial reporting framework.

Communication with Management and Those Charged with Governance (Ref: Para. 27)

A46. The appropriate timing for communications will vary with the circumstances of the compilation engagement. Relevant circumstances include the significance and nature of the matter and any action expected to be taken by management or those charged with governance. For example, it may be appropriate to communicate a significant difficulty encountered during the engagement as soon as practicable if management or those charged with governance are able to assist the practitioner to overcome the difficulty.

A47. Relevant ethical requirements may include a requirement to report identified or suspected non-compliance with laws and regulations to an appropriate level of management or those charged with governance. In some jurisdictions, law or regulation may restrict the practitioner's communication of certain matters with management or those charged with governance. Law or regulation may specifically prohibit a communication, or other action, that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act, including alerting the entity, for example, when the practitioner is required to report the identified or suspected non-compliance to an appropriate authority pursuant to anti-money laundering legislation.[8a] In these circumstances, the issues considered by the practitioner may be complex and the practitioner may consider it appropriate to obtain legal advice.

Performing the Engagement

The Practitioner's Understanding (Ref: Para. 28)

A48. Obtaining an understanding of the entity's business and its operations, including the entity's accounting system and accounting records, is an ongoing process that occurs throughout the compilation engagement. The understanding establishes a frame of reference within which the practitioner exercises professional judgment in compiling the financial information.

A49. The breadth and depth of the understanding the practitioner has or obtains about the entity's business and operations is less than that possessed by management. It is directed at the level that is sufficient for the practitioner to be able to compile the financial information under the terms of the engagement.

A50. Examples of matters the practitioner may consider in obtaining an understanding of the entity's business and operations and the applicable financial reporting framework include:

- The size and complexity of the entity and its operations.
- The complexity of the financial reporting framework.

[8a] Additional guidance is provided in Appendix 4 of HKSA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*.

- The entity's financial reporting obligations or requirements, whether they exist under applicable laws and regulation, under the provisions of a contract or other form of agreement with a third party, or in the context of voluntary financial reporting arrangements.

- The level of development of the entity's management and governance structure regarding management and oversight of the entity's accounting records and financial reporting systems that underpin the preparation of financial information of the entity.

- The level of development and complexity of the entity's financial accounting and reporting systems and related controls.

- The nature of the entity's assets, liabilities, revenues and expenses.

Compiling the Financial Information

Significant Judgments (Ref: Para.30)

A51. In some compilation engagements, the practitioner does not provide assistance to management with significant judgments. In other engagements, the practitioner may provide such assistance, for example, in relation to a required accounting estimate or helping management with its consideration of appropriate accounting policies. Where assistance is provided, discussion is needed so that management and those charged with governance, as appropriate, understand the significant judgments reflected in the financial information, and accept their responsibility for those judgments.

Reading the Financial Information (Ref: Para. 31)

A52. The practitioner's reading of the financial information is intended to assist the practitioner in fulfilling the practitioner's ethical obligations relevant to the compilation engagement.

Proposing Amendments to the Financial Information

Reference to or description of the applicable financial reporting framework (Ref: Para. 34(a))

A53. There may be circumstances when the applicable financial reporting framework is an established financial reporting framework with significant departures therefrom. If the description of the applicable financial reporting framework in the compiled financial information makes reference to the established framework with significant departures, the practitioner may need to consider whether the reference to the established framework is misleading in the circumstances of the engagement.

Amendment for material misstatements, and for the information not to be misleading (Ref: Para. 34(b)–(c))

A54. The practitioner's consideration of materiality is made in the context of the applicable financial reporting framework. Some financial reporting frameworks discuss the concept of materiality in the context of the preparation and presentation of financial information. Although financial reporting frameworks may discuss materiality in different terms, they generally explain that:

- Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial information;

- Judgments about materiality are made in light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both; and

- Judgments about matters that are material to users of the financial information are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.

A55. If present in the applicable financial reporting framework, such a discussion provides a frame of reference for the practitioner in understanding materiality for the purpose of the compilation engagement. If not present, the above considerations provide the practitioner with a frame of reference.

A56. The practitioner's perception of the needs of users of the financial information affects the practitioner's view of materiality. In this context, it is reasonable for the practitioner to assume that users:

- Have a reasonable knowledge of business and economic activities and accounting, and a willingness to study the financial information with reasonable diligence;
- Understand that financial information is prepared and presented to levels of materiality;
- Recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment and the consideration of future events; and
- Make reasonable economic decisions on the basis of the information in the financial information.

A57. The applicable financial reporting framework may include the premise that the financial information is prepared on the going concern basis. If the practitioner becomes aware that uncertainties exist regarding the entity's ability to continue as a going concern, the practitioner may, as appropriate, suggest a more appropriate presentation under the applicable financial reporting framework, or appropriate disclosures concerning the entity's ability to continue as a going concern, in order to be in compliance with that framework, and to avoid the financial information being misleading.

Conditions that Require the Practitioner to Withdraw from the Engagement (Ref: Para. 33, 35)

A58. In circumstances addressed by the requirements of this HKSRS where withdrawal from the engagement is necessary, the responsibility to inform management and those charged with governance of the reasons for withdrawing provides an opportunity to explain the practitioner's ethical obligations.

Documentation (Ref: Para. 38)

A59. The documentation required by this HKSRS serves a number of purposes, including the following:

- Providing a record of matters of continuing relevance to future compilation engagements.
- Enabling the engagement team, as applicable, to be accountable for its work, including recording the completion of the engagement.

A60. The practitioner may consider also including in the engagement documentation a copy of the entity's trial balance, summary of significant accounting records or other information that the practitioner used to perform the compilation.

A61. In recording how the compiled financial information reconciles with the underlying records, documents, explanations and other information provided by management for the purpose of the compilation engagement, the practitioner may, for example, keep a schedule showing the reconciliation of the entity's general ledger account balances to the compiled financial information, including any adjusting journal entries or other amendments to the financial information that the practitioner has agreed with management in the course of the engagement.

The Practitioner's Report (Ref: Para. 40)

A62. The written report encompasses reports issued in hard copy format and those issued using an electronic medium.

A63. When the practitioner is aware that the compiled financial information and the practitioner's report will be included in a document that contains other information, such as a financial report, the practitioner may consider, if the form of presentation allows, identifying the page numbers on which the financial information is presented. This helps users to identify the financial information to which the practitioner's report relates.

Addressees of the Report (Ref: Para. 40(b))

A64. Law or regulation may specify to whom the practitioner's report is to be addressed in the particular jurisdiction. The practitioner's report is normally addressed to the party who engaged the practitioner under the terms of the engagement, ordinarily the management of the entity.

Financial Information Prepared Using a Special Purpose Financial Reporting Framework (Ref: Para. 40(j))

A65. Under this HKSRS, if the financial information is prepared using a special purpose financial reporting framework, the practitioner's report is required to draw the attention of readers of the report to the special purpose financial reporting framework used in the financial information, and to state that the financial information may therefore not be suitable for other purposes. This may be supplemented by an additional clause that restricts either the distribution or use, or both, of the practitioner's report to the intended users only.

A66. Financial information prepared for a particular purpose may be obtained by parties other than the intended users, who may seek to use the information for purposes other than those for which the information was intended. For example, a regulator may require certain entities to provide financial statements prepared using a special purpose financial reporting framework, and those financial statements to be on public record. The fact of the wider availability of those financial statements to parties other than the intended users does not mean the financial statements would then become general purpose financial statements. The practitioner's statements required to be included in the practitioner's report are needed to draw readers' attention to the fact that the financial statements are prepared under a special purpose financial reporting framework, and may not, therefore, be suitable for other purposes.

Restriction on Distribution and Use of the Practitioner's Report

A67. The practitioner may consider it appropriate to indicate that the practitioner's report is intended solely for the specified intended users of the financial information. Depending on the law or regulation of the particular jurisdiction, this may be achieved by restricting either the distribution or use, or both, of the practitioner's report to the intended users only.

Completion of the Compilation Engagement and Dating of the Practitioner's Report (Ref: Para. 37, 38, 41)

A68. The process that exists within the entity for the approval of the financial information by management, or by those charged with governance as appropriate, is a relevant consideration for the practitioner when completing the compilation engagement. Depending on the nature and purpose of the financial information, there may be an established approval process that management or those charged with governance are required to follow, or that is prescribed in applicable law and regulation, for the preparation and finalization of financial information or financial statements of the entity.

Illustrative Reports (Ref: Para. 40)

A69. Appendix 2 to this HKSRS contains illustrations of practitioners' compilation reports incorporating the required elements of the report.

Appendix 1

(Ref: Para. A44)

Illustrative Engagement Letter for a Compilation Engagement

The following is an example of an engagement letter for a compilation engagement that illustrates the relevant requirements and guidance contained in this HKSRS. This letter is not authoritative but is intended only to be a guide that may be used in conjunction with the considerations outlined in this HKSRS. It will need to be adapted according to the requirements and circumstances of individual compilation engagements. It is drafted to refer to the compilation of financial statements for a single reporting period and would require adaptation if intended or expected to apply to a recurring engagement as described in this HKSRS. It may be appropriate to seek legal advice that any proposed letter is suitable.

This engagement letter illustrates the following circumstances:

- The financial statements are to be compiled for sole use by the management of a company (ABC Company), and use of the financial statements will be restricted to management. Use and distribution of the practitioner's report is also restricted to management.
- The compiled financial statements will comprise only the balance sheet of the company as at 31 December 20X1 and the income statement for the year then ended, without notes. Management has determined that the financial statements be prepared on an accrual basis as described.

***

To the Management[9] of ABC Company:

[The objective and scope of the compilation engagement]

You have requested that we provide the following services:

On the basis of information that you will provide, we will assist you in the preparation and presentation of the following financial statements for ABC Company: the balance sheet of ABC Company as at 31 December 20X1 and the income statement for the year then ended, on the historical cost basis, reflecting all cash transactions with the addition of trade accounts payable, trade accounts receivable less an allowance for doubtful accounts, inventory accounted for on an average cost basis, current income taxes payable as at the reporting date, and capitalization of significant long-lived assets at historical cost amortized over their estimated useful lives on the straight-line basis. These financial statements will not include explanatory notes, other than a note describing the basis of accounting as set out in this engagement letter.

The purpose for which the financial statements will be used is to provide full-year financial information showing the entity's financial position at the financial reporting date of 31 December 20X1 and financial performance for the year then ended. The financial statements will be solely for your use, and will not be distributed to other parties.

[9] Throughout this illustrative engagement letter, references to "you," "we," "us," "management," "those charged with governance" and "practitioner" would be used or amended as appropriate in the circumstances.

Our Responsibilities

A compilation engagement involves applying expertise in accounting and financial reporting to assist you in the preparation and presentation of financial information. Since a compilation engagement is not an assurance engagement, we are not required to verify the accuracy or completeness of the information you provide to us for the compilation engagement, or otherwise to gather evidence to express an audit opinion or a review conclusion. Accordingly, we will not express an audit opinion or a review conclusion on whether the financial statements are prepared in accordance with the basis of accounting you have specified, as described above.

We will perform the compilation engagement in accordance with the Hong Kong Standard on Related Services (HKSRS) 4410 (Revised), *Compilation Engagements*. HKSRS 4410 (Revised) requires that, in undertaking this engagement, we comply with relevant ethical requirements, including principles of integrity, objectivity, professional competence and due care. For that purpose, we are required to comply with the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants* (the Code).

Your Responsibilities

The compilation engagement to be performed is conducted on the basis that you acknowledge and understand that our role is to assist you in the preparation and presentation of the financial statements in accordance with the financial reporting framework you have adopted for the financial statements. Accordingly, you have the following overall responsibilities that are fundamental to our undertaking the compilation engagement in accordance with HKSRS 4410 (Revised):

(a) Responsibility for the financial statements and the preparation and presentation thereof in accordance with a financial reporting framework that is acceptable in view of the intended use of the financial statements and the intended users.

(b) Responsibility for the accuracy and completeness of the records, documents, explanations and other information you provide to us for the purpose of compiling the financial statements.

(c) Responsibility for the judgments needed in the preparation and presentation of the financial statements, including those for which we may provide assistance in the course of the compilation engagement.

Our Compilation Report

As part of our engagement, we will issue our report attached to the financial statements compiled by us, which will describe the financial statements, and the work we performed for this compilation engagement [see attached]. The report will also note that the use of the financial statements is restricted to the purpose set out in this engagement letter, and that use and distribution of our report provided for the compilation engagement is restricted to you, as the management of ABC Company.[9a]

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to compile the financial statements described herein, and our respective responsibilities.

[*Other relevant information*]

[*Insert other information, such as fee arrangements, billings and other specific terms, as appropriate*.]

XYZ & Co.

[9a] Practitioners may consider it appropriate to include a limitation of liability clause in accordance with their risk management policies.

Acknowledged and agreed on behalf of the management of ABC Company by

(signed)

....
Name and Title

Date

Appendix 2

(Ref: Para. A69)

Illustrative Practitioners' Compilation Reports

Compilation Engagement for General Purpose Financial Statements

- Illustration 1: Practitioner's report for an engagement to compile financial statements using a general purpose financial reporting framework.

Compilation Engagement for Financial Statements Prepared for a Special Purpose

- Illustration 2: Practitioner's report for an engagement to compile financial statements using a modified general purpose financial reporting framework.

Compilation Engagements for Financial Information Prepared for a Special Purpose where Use or Distribution of the Financial Information Is Restricted to the Intended Users

- Illustration 3: Practitioner's report for an engagement to compile financial statements using the basis of accounting specified in a contract.

- Illustration 4: Practitioner's report for an engagement to compile financial statements using a basis of accounting selected by the management of an entity for financial information required for management's own purposes.

- Illustration 5: Practitioner's report for an engagement to compile financial information that is an element, account or item, being [*insert appropriate reference to information required for a regulatory compliance purpose*].

Illustration 1: Practitioner's report for an engagement to compile financial statements using a general purpose financial reporting framework.

- General purpose financial statements required under applicable law that specifies that the entity's financial statements are to be prepared applying Hong Kong Financial Reporting Standards for Private Entities (HKFRS-PE).

PRACTITIONER'S COMPILATION REPORT

[To Management of ABC Company]

We have compiled the accompanying financial statements of ABC Company based on information you have provided. These financial statements comprise the statement of financial position of ABC Company as at 31 December 20X1, the statement of comprehensive income, 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.

We performed this compilation engagement in accordance with Hong Kong Standard on Related Services 4410 (Revised), *Compilation Engagements*.

We have applied our expertise in accounting and financial reporting to assist you in the preparation and presentation of these financial statements in accordance with Hong Kong Financial Reporting Standards for Private Entities (HKFRS-PE). We have complied with relevant ethical requirements, including principles of integrity, objectivity, professional competence and due care.

These financial statements and the accuracy and completeness of the information used to compile them are your responsibility. [9b]

Since a compilation engagement is not an assurance engagement, we are not required to verify the accuracy or completeness of the information you provided to us to compile these financial statements. Accordingly, we do not express an audit opinion or a review conclusion on whether these financial statements are prepared in accordance with HKFRS-PE.

[Practitioner's signature]

[Date of practitioner's report]

[Practitioner's address]

[9b] Practitioners 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 "Auditor's Duty of Care To Third Parties and The Audit Report".

Illustration 2: Practitioner's report for an engagement to compile financial statements using a modified general purpose financial reporting framework.

- Financial statements prepared using a general purpose financial reporting framework adopted by management on a modified basis.
- The applicable financial reporting framework is Hong Kong Financial Reporting Standards for Private Entities (HKFRS-PE) excluding the treatment of property, which has been revalued rather than being carried at historical cost.
- Use or distribution of the financial statements is not restricted.

PRACTITIONER'S COMPILATION REPORT

[To Management of ABC Company]

We have compiled the accompanying financial statements of ABC Company based on information you have provided. These financial statements comprise the statement of financial position of ABC Company as at 31 December 20X1, the statement of comprehensive income, 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.

We performed this compilation engagement in accordance with Hong Kong Standard on Related Services 4410 (Revised), *Compilation Engagements*.

We have applied our expertise in accounting and financial reporting to assist you in the preparation and presentation of these financial statements on the basis of accounting described in Note X to the financial statements. We have complied with relevant ethical requirements, including principles of integrity, objectivity, professional competence and due care.

These financial statements and the accuracy and completeness of the information used to compile them are your responsibility.

Since a compilation engagement is not an assurance engagement, we are not required to verify the accuracy or completeness of the information you provided to us to compile these financial statements. Accordingly, we do not express an audit opinion or a review conclusion on whether these financial statements are prepared in accordance with the basis of accounting described in Note X.

As stated in Note X, the financial statements are prepared and presented in accordance with Hong Kong Financial Reporting Standards for Private Entities (HKFRS-PE), excluding property which is revalued in the financial statements rather than being carried at historical cost. The financial statements are prepared for the purpose described in Note Y to the financial statements. Accordingly, these financial statements may not be suitable for other purposes.[9c]

[Practitioner's signature]

[Date of practitioner's report]

[Practitioner's address]

[9c] Practitioners 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 "Auditor's Duty of Care To Third Parties and The Audit Report".

Illustration 3: Practitioner's report for an engagement to compile financial statements using the basis of accounting specified in a contract.

- Financial statements prepared to comply with the provisions of a contract, applying the basis of accounting specified in the contract.
- The practitioner is engaged by a party other than management or those charged with governance of the entity.
- The financial statements are intended for use only by the parties specified in the contract.
- Distribution and use of the practitioner's report is restricted to the intended users of the financial statements specified in the contract.

PRACTITIONER'S COMPILATION REPORT

[To the Engaging Party[10]]

We have compiled the accompanying financial statements of ABC Company ("the Company") based on information provided by the management of the Company ("management"). These financial statements comprise *[name all the elements of the financial statements prepared under the basis of accounting specified in the Contract and the period/date to which they relate*].

We performed this compilation engagement in accordance with Hong Kong Standard on Related Services 4410 (Revised), *Compilation Engagements*.

We have applied our expertise in accounting and financial reporting to assist management in the preparation and presentation of these financial statements on the basis of accounting described in Note X to the financial statements. We have complied with relevant ethical requirements, including principles of integrity, objectivity, professional competence and due care.

These financial statements and the accuracy and completeness of the information used to compile them are management's responsibility.

Since a compilation engagement is not an assurance engagement, we are not required to verify the accuracy or completeness of the information provided to us by management to compile these financial statements. Accordingly, we do not express an audit opinion or a review conclusion on whether these financial statements are prepared in accordance with the basis of accounting described in Note X.

As stated in Note X, the financial statements are prepared and presented on the basis described in Clause Z of the provisions of the Company's contract with XYZ Limited dated *[insert date of the relevant contract/agreement*] ("the Contract"), and for the purpose described in Note Y to the financial statements. Accordingly, these financial statements are intended for use only by the parties specified in the Contract, and may not be suitable for other purposes.

Our compilation report is intended solely for the parties specified in the Contract, and should not be distributed to other parties.[10a]

[Practitioner's signature]

[Date of practitioner's report]

[Practitioner's address]

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10 Alternatively, the appropriate addressee specified in the relevant contract

10a Practitioners 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 "Auditor's Duty of Care To Third Parties and The Audit Report".

Illustration 4: Practitioner's report for an engagement to compile financial statements using a basis of accounting selected by management of an entity for financial information required for management's own purposes.

- Financial statements prepared using a special purpose financial reporting framework, intended for use only by the management of a company for management's own purposes.
- The financial statements incorporate certain accruals, and comprise only a balance sheet, an income statement, and a single note that refers to the basis of accounting used for the financial statements.
- The financial statements are intended for use only by management.
- Distribution and use of the practitioner's report is restricted to management.

PRACTITIONER'S COMPILATION REPORT

[To Management of ABC Company]

We have compiled the accompanying financial statements of ABC Company based on information you have provided. These financial statements comprise the balance sheet of ABC Company as at 31 December 20X1 and an income statement for the year then ended.

We performed this compilation engagement in accordance with Hong Kong Standard on Related Services 4410 (Revised), *Compilation Engagements*.

We have applied our expertise in accounting and financial reporting to assist you in the preparation and presentation of these financial statements on the basis of accounting described in Note X to the financial statements. We have complied with relevant ethical requirements, including principles of integrity, objectivity, professional competence and due care.

These financial statements and the accuracy and completeness of the information used to compile them are your responsibility.

Since a compilation engagement is not an assurance engagement, we are not required to verify the accuracy or completeness of the information you provided to us to compile these financial statements. Accordingly, we do not express an audit opinion or a review conclusion on whether these financial statements are prepared in accordance with the basis of accounting described in Note X.

Note X states the basis on which these financial statements are prepared, and their purpose is described in Note Y. Accordingly, these financial statements are for your use only, and may not be suitable for other purposes.

Our compilation report is intended solely for your use in your capacity as management of ABC Company, and should not be distributed to other parties.[10b]

[Practitioner's signature]

[Date of practitioner's report]

[Practitioner's address]

[10b] Practitioners 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 "Auditor's Duty of Care To Third Parties and The Audit Report".

Illustration 5: Practitioner's report for an engagement to compile financial information that is an element, account or item, being [insert appropriate reference to information required for a regulatory compliance purpose].

- Financial information prepared for a special purpose, i.e., to comply with financial reporting requirements established by a regulator, in accordance with provisions established by the regulator prescribing the form and content of the financial information.
- The applicable financial reporting framework is a compliance framework.
- The financial information is intended to meet the needs of particular users, and use of the financial information is restricted to those users.
- Distribution of the practitioner's report is restricted to the intended users.

PRACTITIONER'S COMPILATION REPORT

[To the Management of ABC Company[11]]

We have compiled the accompanying schedule of [*identify the compiled financial information*] of ABC Company as at 31 December 20X1 ("the Schedule") based on information you have provided.

We performed this compilation engagement in accordance with Hong Kong Standard on Related Services 4410 (Revised), *Compilation Engagements*.

We have applied our expertise in accounting and financial reporting to assist you in the preparation and presentation of the Schedule as prescribed by [*insert name of or reference to the relevant regulation*]. We have complied with relevant ethical requirements, including principles of integrity, objectivity, professional competence and due care.

This Schedule and the accuracy and completeness of the information used to compile it are your responsibility.

Since a compilation engagement is not an assurance engagement, we are not required to verify the accuracy or completeness of the information you provided to us to compile the Schedule. Accordingly, we do not express an audit opinion or a review conclusion on whether the Schedule is prepared in accordance with [*insert name of or reference to applicable financial reporting framework as specified in the relevant regulation*].

As stated in Note X, the Schedule is prepared and presented on the basis prescribed by [*insert name of or reference to the applicable financial reporting framework as specified in the relevant regulation*], for the purpose of ABC Company's compliance with [insert name of or reference to the relevant regulation]. Accordingly, the Schedule is for use only in connection with that purpose and may not be suitable for any other purpose.

Our compilation report is intended solely for the use of ABC Company and Regulator F, and should not be distributed to parties other than ABC Company or Regulator F.[11a]

[Practitioner's signature]

[Date of the practitioner's report]

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11 Alternatively, the appropriate addressee specified in the applicable financial reporting requirements

11a Practitioners 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 "Auditor's Duty of Care To Third Parties and The Audit Report".

[Practitioner's address]