



MEMBERS' HANDBOOK

Update No. 255

(Issued 29 January 2021)

VOLUME III

Document Reference and Title	Instructions	Explanations
Contents of Volume III	Discard existing pages i, ii and iv and replace with the revised pages i, ii and iv.	Revised contents pages
Preface (Amended) Amended Preface to the Hong Kong Quality Control, Auditing, Review, Other Assurance and Related Services Pronouncements	Replace cover page, pages 2 and 3 with revised cover page, pages 2 and 3.	Note 1
HONG KONG STANDARDS ON AUDITING		
HKSA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing	Replace cover page, pages 2, 10 and 19 to 26 with revised cover page, pages 2, 10 and 19 to 27.	Note 2
HKSA 230 Audit Documentation	Replace cover page, pages 2, 7, 8, 9 and 13 with revised cover page, pages 2, 7, 8, 9 and 13.	- ditto -
HKSA 240 The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements	Replace cover page, pages 2, 13, 24, 25 and 26 with revised cover page, pages 2, 13, 24, 25 and 26.	- ditto -
HKSA 250 (Revised) Consideration of Laws and Regulations in an Audit of Financial Statements	Replace cover page, pages 2 and 10 with revised cover page, pages 2 and 10.	Note 3
HKSA 260 (Revised) Communication with Those Charged with Governance	Replace cover page, pages 2, 8, 13, 22, 24 and 25 with revised cover page, pages 2, 8, 13, 22, 24 and 25.	Note 2
HKSA 315 (Revised 2019) Identifying and Assessing the Risks of Material Misstatement	Replace cover page, pages 2, 15, 19 and 69 with revised cover page, pages 2, 15, 19 and 69.	- ditto -

<u>HKSA 500 Audit Evidence</u>	Discard HKSA 500 revised in January 2019 and replace with the attached HKSA 500.	- ditto -
<u>HKSA 505 External Confirmations</u>	Replace cover page, pages 2, 4, 5, 7 and 9 with revised cover page, pages 2, 4, 5, 7 and 9.	- ditto -
<u>HKSA 520 Analytical Procedures</u>	Replace cover page, pages 2, 5 and 7 with revised cover page and pages 2, 5 and 7.	- ditto -
<u>HKSA 540 (Revised) Auditing Accounting Estimates and Related Disclosures</u>	Replace cover page, pages 2, 14, 32, 41 and 42 with revised cover page, pages 2, 14, 32, 41 and 42. Discard pages 55 to 82.	- ditto -
<u>HKSA 580 Written Representations</u>	Replace cover page, pages 2, 7, 13, 15 and 16 with revised cover page, pages 2, 7, 13, 15 and 16.	- ditto -
<u>HKSA 620 Using the Work of an Auditor's Expert</u>	Replace cover page, pages 2, 4 and 7 with revised cover page, pages 2, 4 and 7.	- ditto -
<u>HKSA 700 (Revised) Forming an Opinion and Reporting on Financial Statements</u>	Replace cover page, pages 2, 6, 15 and 53 with revised cover page, pages 2, 6, 15 and 53.	- ditto -
<u>HKSA 701 Communicating Key Audit Matters in the Independent Auditor's Report</u>	Replace cover page, pages 2, 5, 7 and 12 with revised cover page, pages 2, 5, 7 and 12.	- ditto -

PRACTICE NOTES

<u>PN 860.1 (Revised) The Audit of Retirement Schemes</u>	Replace cover page and page 11 with revised cover page and page 11.	- ditto -
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Notes:

1. Revision to paragraph 6 of the Preface (Amended).
2. Conforming amendments as a result of HKSA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures* 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 2019.
3. Editorial revision to paragraph 31 of HKSA 250 (Revised).

In order for readers to easily identify all the changes, the marked-ups to the relevant standards are posted at: <https://www.hkicpa.org.hk/-/media/Document/SSD/handbookupdate/255mk.pdf>



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Amended Preface
Issued July 2012; revised July 2020, January 2021

Amended Preface to the Hong Kong Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements



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AMENDED PREFACE TO THE HONG KONG QUALITY CONTROL, AUDITING, REVIEW, OTHER ASSURANCE, AND RELATED SERVICES PRONOUNCEMENTS

Introduction

1. This Preface to the Hong Kong Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements is issued to facilitate understanding of the scope and authority of the pronouncements the Hong Kong Institute of Certified Public Accountants (HKICPA) issues.
2. This Preface is issued to set out the objectives and due process of the Council of the HKICPA (hereafter referred as the “Council”) in respect of setting Hong Kong Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements.
3. This Preface also sets out the relationship between Hong Kong Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements and International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants, and the authority attaching to locally developed Practice Notes (PNs), Auditing Guidelines (AGs), Auditing and Assurance Technical Bulletins and Circulars.

Appendix 1 illustrates the structure of the Hong Kong Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements.

Objectives of Council

4. Pursuant to section 18A of the Professional Accountants Ordinance, Council may, in relation to the practice of accountancy, issue or specify any standards of auditing practices required to be observed, maintained or otherwise applied by members of the HKICPA (members). Approval of Hong Kong Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements and related documents, such as exposure drafts, and other discussion documents, is the responsibility of Council.
5. Council has mandated the Auditing and Assurance Standards Committee (AASC) to develop Hong Kong Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements to achieve convergence with International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements. Within this remit, Council permits the AASC to work in whatever way it considers most effective and efficient and this may include forming advisory working groups or other forms of specialist advisory groups to give advice in preparing new and revised Hong Kong Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements.
6. [Not used]
7. In 2001, Council adopted the policy of achieving convergence of Hong Kong Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements with International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements (the Convergence). Council’s objectives in this respect are:
 - (a) to establish high quality auditing standards and guidance for financial statement audits that are generally accepted and recognized by investors, auditors, governments, regulators and other key stakeholders;

HKSA 200
Issued June 2009; revised July 2010, May 2013, February 2015,
January 2016, June 2017, September 2019, July 2020,
January 2021

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

Hong Kong Standard on Auditing 200

Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing



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Complying with Relevant Requirements

22. Subject to paragraph 23, the auditor shall comply with each requirement of an HKSA unless, in the circumstances of the audit:
- (a) The entire HKSA is not relevant; or
 - (b) The requirement is not relevant because it is conditional and the condition does not exist. (Ref: Para. A74-A75)
23. In exceptional circumstances, the auditor may judge it necessary to depart from a relevant requirement in an HKSA. In such circumstances, the auditor shall perform alternative audit procedures to achieve the aim of that requirement. The need for the auditor 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 audit, that procedure would be ineffective in achieving the aim of the requirement. (Ref: Para. A76)

Failure to Achieve an Objective

24. If an objective in a relevant HKSA cannot be achieved, the auditor shall evaluate whether this prevents the auditor from achieving the overall objectives of the auditor and thereby requires the auditor, in accordance with the HKSAs, to modify the auditor's opinion or withdraw from the engagement (where withdrawal is possible under applicable law or regulation). Failure to achieve an objective represents a significant matter requiring documentation in accordance with HKSA 230.⁴ (Ref: Para. A77-A78)

Conformity and Compliance with International Standards on Auditing

25. As of January 2021, this HKSA conforms with International Standard on Auditing (ISA) 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing* except that references to IESBA's Code of Ethics for Professional Accountants are replaced by HKICPA's Code of Ethics for Professional Accountants. With the exception of the forgoing difference, compliance with the requirements of this HKSA ensures compliance with ISA 200.

Application and Other Explanatory Material

An Audit of Financial Statements

Scope of the Audit (Ref: Para. 3)

- A1. The auditor's opinion on the financial statements deals with whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. Such an opinion is common to all audits of financial statements. The auditor's opinion therefore does not assure, for example, the future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity. In some jurisdictions, however, applicable law or regulation may require auditors to provide opinions on other specific matters, such as the effectiveness of internal control, or the consistency of a separate management report with the financial statements. While the HKSAs include requirements and guidance in relation to such matters to the extent that they are relevant to forming an opinion on the financial statements, the auditor would be required to undertake further work if the auditor had additional responsibilities to provide such opinions.

⁴ HKSA 230, *Audit Documentation*, paragraph 8(c)

being circumvented by collusion or inappropriate management override. Accordingly, some control risk will always exist. The HKSAs provide the conditions under which the auditor is required to, or may choose to, test the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures to be performed.¹⁸

A42. The assessment of the risks of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made. The HKSAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement." However, HKSA 540 (Revised)¹⁹ requires a separate assessment of inherent risk and control risk to provide a basis for designing and performing further audit procedures to respond to the assessed risks of material misstatement, including significant risks, for accounting estimates at the assertion level in accordance with HKSA 330.²⁰ In identifying and assessing risks of material misstatement for significant classes of transactions, account balances or disclosures other than accounting estimates, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations.

A43. HKSA 315 (Revised) establishes requirements and provides guidance on identifying and assessing the risks of material misstatement at the financial statement and assertion levels.

Detection Risk

A44. For a given level of audit risk, the acceptable level of detection risk bears an inverse relationship to the assessed risks of material misstatement at the assertion level. For example, the greater the risks of material misstatement the auditor believes exists, the less the detection risk that can be accepted and, accordingly, the more persuasive the audit evidence required by the auditor.

A45. Detection risk relates to the nature, timing and extent of the auditor's procedures that are determined by the auditor to reduce audit risk to an acceptably low level. It is therefore a function of the effectiveness of an audit procedure and of its application by the auditor. Matters such as:

- adequate planning;
- proper assignment of personnel to the engagement team;
- the application of professional skepticism; and
- supervision and review of the audit work performed,

assist to enhance the effectiveness of an audit procedure and of its application and reduce the possibility that an auditor might select an inappropriate audit procedure, misapply an appropriate audit procedure, or misinterpret the audit results.

A46. HKSA 300²¹ and HKSA 330 establish requirements and provide guidance on planning an audit of financial statements and the auditor's responses to assessed risks. Detection risk,

¹⁸ HKSA 330, *The Auditor's Responses to Assessed Risks*, paragraphs 7-17

¹⁹ HKSA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*, paragraph 16

²⁰ HKSA 330, paragraph 7(b)

²¹ HKSA 300, *Planning an Audit of Financial Statements*

however, can only be reduced, not eliminated, because of the inherent limitations of an audit. Accordingly, some detection risk will always exist.

Inherent Limitations of an Audit

A47. The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive. The inherent limitations of an audit arise from:

- The nature of financial reporting;
- The nature of audit procedures; and
- The need for the audit to be conducted within a reasonable period of time and at a reasonable cost.

The Nature of Financial Reporting

A48. The preparation of financial statements involves judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty, and there may be a range of acceptable interpretations or judgments that may be made. Consequently, some financial statement items are subject to an inherent level of variability which cannot be eliminated by the application of additional auditing procedures. For example, this is often the case with respect to certain accounting estimates. Nevertheless, the HKSAs require the auditor to give specific consideration to whether accounting estimates are reasonable in the context of the applicable financial reporting framework and related disclosures, and to the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.²²

The Nature of Audit Procedures

A49. There are practical and legal limitations on the auditor's ability to obtain audit evidence. For example:

- There is the possibility that management or others may not provide, intentionally or unintentionally, the complete information that is relevant to the preparation of the financial statements or that has been requested by the auditor. Accordingly, the auditor cannot be certain of the completeness of information, even though the auditor has performed audit procedures to obtain assurance that all relevant information has been obtained.

²² HKSA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*, and HKSA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, paragraph 12

- Fraud may involve sophisticated and carefully organized schemes designed to conceal it. Therefore, audit procedures used to gather audit evidence may be ineffective for detecting an intentional misstatement that involves, for example, collusion to falsify documentation which may cause the auditor to believe that audit evidence is valid when it is not. The auditor is neither trained as nor expected to be an expert in the authentication of documents.
- An audit is not an official investigation into alleged wrongdoing. Accordingly, the auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation.

Timeliness of Financial Reporting and the Balance between Benefit and Cost

A50. The matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive. Appropriate planning assists in making sufficient time and resources available for the conduct of the audit. Notwithstanding this, the relevance of information, and thereby its value, tends to diminish over time, and there is a balance to be struck between the reliability of information and its cost. This is recognized in certain financial reporting frameworks (see, for example, the HKICPA's "Framework for the Preparation and Presentation of Financial Statements"). Therefore, there is an expectation by users of financial statements that the auditor will form an opinion on the financial statements within a reasonable period of time and at a reasonable cost, recognizing that it is impracticable to address all information that may exist or to pursue every matter exhaustively on the assumption that information is in error or fraudulent until proved otherwise.

A51. Consequently, it is necessary for the auditor to:

- Plan the audit so that it will be performed in an effective manner;
- Direct audit effort to areas most expected to contain risks of material misstatement, whether due to fraud or error, with correspondingly less effort directed at other areas; and
- Use testing and other means of examining populations for misstatements.

A52. In light of the approaches described in paragraph A51, the HKSAs contain requirements for the planning and performance of the audit and require the auditor, among other things, to:

- Have a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels by performing risk assessment procedures and related activities;²³ and
- Use testing and other means of examining populations in a manner that provides a reasonable basis for the auditor to draw conclusions about the population.²⁴

Other Matters that Affect the Inherent Limitations of an Audit

A53. In the case of certain assertions or subject matters, the potential effects of the inherent limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include:

²³ HKSA 315 (Revised), paragraphs 5-10

²⁴ HKSA 330; HKSA 500; HKSA 520, *Analytical Procedures*; HKSA 530, *Audit Sampling*

- Fraud, particularly fraud involving senior management or collusion. See HKSA 240 for further discussion.
- The existence and completeness of related party relationships and transactions. See HKSA 550²⁵ for further discussion.
- The occurrence of non-compliance with laws and regulations. See HKSA 250²⁶ for further discussion.
- Future events or conditions that may cause an entity to cease to continue as a going concern. See HKSA 570²⁷ for further discussion.

Relevant HKSAs identify specific audit procedures to assist in mitigating the effect of the inherent limitations.

A54. Because of 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 HKSAs. Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with HKSAs. However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with less than persuasive audit evidence. Whether the auditor has performed an audit in accordance with HKSAs is determined by the audit procedures performed in the circumstances, the sufficiency and appropriateness of the audit evidence obtained as a result thereof and the suitability of the auditor's report based on an evaluation of that evidence in light of the overall objectives of the auditor.

Conduct of an Audit in Accordance with HKSAs

Nature of the HKSAs (Ref: Para. 18)

- A55. The HKSAs, taken together, provide the standards for the auditor's work in fulfilling the overall objectives of the auditor. The HKSAs deal with the general responsibilities of the auditor, as well as the auditor's further considerations relevant to the application of those responsibilities to specific topics.
- A56. The scope, effective date and any specific limitation of the applicability of a specific HKSA is made clear in the HKSA. Unless otherwise stated in the HKSA, the auditor is permitted to apply an HKSA before the effective date specified therein.
- A57. In performing an audit, the auditor may be required to comply with legal or regulatory requirements in addition to the HKSAs. The HKSAs do not override law or regulation that governs an audit of financial statements. In the event that such law or regulation differs from the HKSAs, an audit conducted only in accordance with law or regulation will not automatically comply with HKSAs.
- A58. The auditor may also conduct the audit in accordance with both HKSAs and auditing standards of a specific jurisdiction or country. In such cases, in addition to complying with each of the HKSAs relevant to the audit, it may be necessary for the auditor to perform additional audit procedures in order to comply with the relevant standards of that jurisdiction or country.

²⁵ HKSA 550, *Related Parties*

²⁶ HKSA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*

²⁷ HKSA 570 (Revised), *Going Concern*

Considerations Specific to Audits in the Public Sector

A59. The HKSAs are relevant to engagements in the public sector. The public sector auditor's responsibilities, however, may be affected by the audit mandate, or by obligations on public sector entities arising from law, regulation or other authority (such as ministerial directives, government policy requirements, or resolutions of the legislature), which may encompass a broader scope than an audit of financial statements in accordance with the HKSAs. These additional responsibilities are not dealt with in the HKSAs. They may be dealt with in the pronouncements of the International Organization of Supreme Audit Institutions or national standard setters, or in guidance developed by government audit agencies.

Contents of the HKSAs (Ref: Para. 19)

A60. In addition to objectives and requirements (requirements are expressed in the HKSAs using "shall"), an HKSA contains related guidance in the form of application and other explanatory material. It may also contain introductory material that provides context relevant to a proper understanding of the HKSA, and definitions. The entire text of an HKSA, therefore, is relevant to an understanding of the objectives stated in an HKSA and the proper application of the requirements of an HKSA.

A61. Where necessary, the application and other explanatory material provides further explanation of the requirements of an HKSA and guidance for carrying them out. In particular, it may:

- Explain more precisely what a requirement means or is intended to cover.
- Include examples of procedures 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 of an HKSA. The application and other explanatory material may also provide background information on matters addressed in an HKSA.

A62. 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 HKSA or within the title and introduction of the appendix itself.

A63. Introductory material may include, as needed, such matters as explanation of:

- The purpose and scope of the HKSA, including how the HKSA relates to other HKSAs.
- The subject matter of the HKSA.
- The respective responsibilities of the auditor and others in relation to the subject matter of the HKSA.
- The context in which the HKSA is set.

A64. An HKSA may include, in a separate section under the heading "Definitions," a description of the meanings attributed to certain terms for purposes of the HKSAs. These are provided to assist in the consistent application and interpretation of the HKSAs, and are not intended to override definitions that may be established for other purposes, whether in law, regulation or otherwise. Unless otherwise indicated, those terms will carry the same meanings throughout the HKSAs. The Glossary of Terms relating to Hong Kong Standards on Auditing and Quality Control issued by the HKICPA contains a complete listing of terms defined in the HKSAs. It also includes descriptions of other terms found in HKSAs to assist in common and consistent interpretation and translation.

A65. When appropriate, additional considerations specific to audits of smaller entities and public sector entities are included within the application and other explanatory material of an HKSA. These additional considerations assist in the application of the requirements of the HKSA in the audit of such entities. They do not, however, limit or reduce the responsibility of the auditor to apply and comply with the requirements of the HKSA.

Considerations Specific to Smaller Entities

A66. For purposes of specifying additional considerations to audits of smaller entities, a "smaller entity" refers to an entity which typically possesses qualitative characteristics such as:

- (a) Concentration of ownership and management in a small number of individuals (often a single individual – either a natural person or another enterprise that owns the entity provided the owner exhibits the relevant qualitative characteristics); and
- (b) One or more of the following:
 - (i) Straightforward or uncomplicated transactions;
 - (ii) Simple record-keeping;
 - (iii) Few lines of business and few products within business lines;
 - (iv) Few internal controls;
 - (v) Few levels of management with responsibility for a broad range of controls; or
 - (vi) Few personnel, many having a wide range of duties.

These qualitative characteristics are not exhaustive, they are not exclusive to smaller entities, and smaller entities do not necessarily display all of these characteristics.

A67. The considerations specific to smaller entities included in the HKSA have been developed primarily with unlisted entities in mind. Some of the considerations, however, may be helpful in audits of smaller listed entities.

A68. The HKSA refer to the proprietor of a smaller entity who is involved in running the entity on a day-to-day basis as the "owner-manager."

Objectives Stated in Individual HKSA (Ref: Para. 21)

A69. Each HKSA contains one or more objectives which provide a link between the requirements and the overall objectives of the auditor. The objectives in individual HKSA serve to focus the auditor on the desired outcome of the HKSA, while being specific enough to assist the auditor in:

- Understanding what needs to be accomplished and, where necessary, the appropriate means of doing so; and
- Deciding whether more needs to be done to achieve them in the particular circumstances of the audit.

A70. Objectives are to be understood in the context of the overall objectives of the auditor stated in paragraph 11 of this HKSA. As with the overall objectives of the auditor, the ability to achieve an individual objective is equally subject to the inherent limitations of an audit.

A71. In using the objectives, the auditor is required to have regard to the interrelationships among the HKSAs. This is because, as indicated in paragraph A55, the HKSAs deal in some cases with general responsibilities and in others with the application of those responsibilities to specific topics. For example, this HKSA requires the auditor to adopt an attitude of professional skepticism; this is necessary in all aspects of planning and performing an audit but is not repeated as a requirement of each HKSA. At a more detailed level, HKSA 315 (Revised) and HKSA 330 contain, among other things, objectives and requirements that deal with the auditor's responsibilities to identify and assess the risks of material misstatement and to design and perform further audit procedures to respond to those assessed risks, respectively; these objectives and requirements apply throughout the audit. An HKSA dealing with specific aspects of the audit (for example, HKSA 540) may expand on how the objectives and requirements of such HKSAs as HKSA 315 (Revised) and HKSA 330 are to be applied in relation to the subject of the HKSA but does not repeat them. Thus, in achieving the objective stated in HKSA 540, the auditor has regard to the objectives and requirements of other relevant HKSAs.

Use of Objectives to Determine Need for Additional Audit Procedures (Ref: Para. 21(a))

A72. The requirements of the HKSAs are designed to enable the auditor to achieve the objectives specified in the HKSAs, and thereby the overall objectives of the auditor. The proper application of the requirements of the HKSAs by the auditor is therefore expected to provide a sufficient basis for the auditor's achievement of the objectives. However, because the circumstances of audit engagements vary widely and all such circumstances cannot be anticipated in the HKSAs, the auditor is responsible for determining the audit procedures necessary to fulfill the requirements of the HKSAs and to achieve the objectives. In the circumstances of an engagement, there may be particular matters that require the auditor to perform audit procedures in addition to those required by the HKSAs to meet the objectives specified in the HKSAs.

Use of Objectives to Evaluate Whether Sufficient Appropriate Audit Evidence Has Been Obtained (Ref: Para. 21(b))

A73. The auditor is required to use the objectives to evaluate whether sufficient appropriate audit evidence has been obtained in the context of the overall objectives of the auditor. If as a result the auditor concludes that the audit evidence is not sufficient and appropriate, then the auditor may follow one or more of the following approaches to meeting the requirement of paragraph 21(b):

- Evaluate whether further relevant audit evidence has been, or will be, obtained as a result of complying with other HKSAs;
- Extend the work performed in applying one or more requirements; or
- Perform other procedures judged by the auditor to be necessary in the circumstances.

Where none of the above is expected to be practical or possible in the circumstances, the auditor will not be able to obtain sufficient appropriate audit evidence and is required by the HKSAs to determine the effect on the auditor's report or on the auditor's ability to complete the engagement.

Complying with Relevant Requirements

Relevant Requirements (Ref: Para. 22)

A74. In some cases, an HKSA (and therefore all of its requirements) may not be relevant in the circumstances. For example, if an entity does not have an internal audit function, nothing in HKSA 610 (Revised 2013)²⁸ is relevant.

A75. Within a relevant HKSA, there may be conditional requirements. Such a requirement is relevant when the circumstances envisioned in the requirement apply and the condition exists. In general, the conditionality of a requirement will either be explicit or implicit, for example:

- The requirement to modify the auditor's opinion if there is a limitation of scope²⁹ represents an explicit conditional requirement.
- The requirement to communicate significant deficiencies in internal control identified during the audit to those charged with governance,³⁰ which depends on the existence of such identified significant deficiencies; and the requirement to obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework,³¹ which depends on that framework requiring or permitting such disclosure, represent implicit conditional requirements.

In some cases, a requirement may be expressed as being conditional on applicable law or regulation. For example, the auditor may be required to withdraw from the audit engagement, *where withdrawal is possible under applicable law or regulation*, or the auditor may be required to do something, *unless prohibited by law or regulation*. Depending on the jurisdiction, the legal or regulatory permission or prohibition may be explicit or implicit.

Departure from a Requirement (Ref: Para. 23)

A76. HKSA 230 establishes documentation requirements in those exceptional circumstances where the auditor departs from a relevant requirement.³² The HKSAs do not call for compliance with a requirement that is not relevant in the circumstances of the audit.

Failure to Achieve an Objective (Ref: Para. 24)

A77. Whether an objective has been achieved is a matter for the auditor's professional judgment. That judgment takes account of the results of audit procedures performed in complying with the requirements of the HKSAs, and the auditor's evaluation of whether sufficient appropriate audit evidence has been obtained and whether more needs to be done in the particular circumstances of the audit to achieve the objectives stated in the HKSAs. Accordingly, circumstances that may give rise to a failure to achieve an objective include those that:

- Prevent the auditor from complying with the relevant requirements of an HKSA.

²⁸ HKSA 610 (Revised 2013), *Using the Work of Internal Auditors*, paragraph 2

²⁹ HKSA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*, paragraph 13

³⁰ HKSA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*, paragraph 9

³¹ HKSA 501, *Audit Evidence—Specific Considerations for Selected Items*, paragraph 13

³² HKSA 230, paragraph 12

OVERALL OBJECTIVES OF THE INDEPENDENT AUDITOR AND THE CONDUCT OF AN AUDIT
IN ACCORDANCE WITH HONG KONG STANDARDS ON AUDITING

- Result in its not being practicable or possible for the auditor to carry out the additional audit procedures or obtain further audit evidence as determined necessary from the use of the objectives in accordance with paragraph 21, for example, due to a limitation in the available audit evidence.

A78. Audit documentation that meets the requirements of HKSA 230 and the specific documentation requirements of other relevant HKSAs provides evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor. While it is unnecessary for the auditor to document separately (as in a checklist, for example) that individual objectives have been achieved, the documentation of a failure to achieve an objective assists the auditor's evaluation of whether such a failure has prevented the auditor from achieving the overall objectives of the auditor.

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Hong Kong Standard on Auditing 230

Audit Documentation



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Conformity and Compliance with International Standards on Auditing

17. As of January 2021, this HKSA conforms with International Standard on Auditing (ISA) 230, *Audit Documentation*. Compliance with the requirements of this HKSA ensures compliance with ISA 230.

Application and Other Explanatory Material

Timely Preparation of Audit Documentation (Ref: Para. 7)

- A1. Preparing sufficient and appropriate audit documentation on a timely basis helps to enhance the quality of the audit and facilitates the effective review and evaluation of the audit evidence obtained and conclusions reached before the auditor's report is finalized. Documentation prepared after the audit work has been performed is likely to be less accurate than documentation prepared at the time such work is performed.

Documentation of the Audit Procedures Performed and Audit Evidence Obtained

Form, Content and Extent of Audit Documentation (Ref: Para. 8)

- A2. The form, content and extent of audit documentation depend on factors such as:
- The size and complexity of the entity.
 - The nature of the audit procedures to be performed.
 - The identified risks of material misstatement.
 - The significance of the audit evidence obtained.
 - The nature and extent of exceptions identified.
 - The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained.
 - The audit methodology and tools used.
- A3. Audit documentation may be recorded on paper or on electronic or other media. Examples of audit documentation include:
- Audit programs.
 - Analyses.
 - Issues memoranda.
 - Summaries of significant matters.
 - Letters of confirmation and representation.
 - Checklists.
 - Correspondence (including e-mail) concerning significant matters.

The auditor may include abstracts or copies of the entity's records (for example, significant and specific contracts and agreements) as part of audit documentation. Audit documentation, however, is not a substitute for the entity's accounting records.

- A4. The auditor need not include in audit documentation superseded drafts of working papers and financial statements, notes that reflect incomplete or preliminary thinking, previous copies of documents corrected for typographical or other errors, and duplicates of documents.
- A5. Oral explanations by the auditor, on their own, do not represent adequate support for the work the auditor performed or conclusions the auditor reached, but may be used to explain or clarify information contained in the audit documentation.

Documentation of Compliance with HKSA's (Ref: Para. 8(a))

- A6. In principle, compliance with the requirements of this HKSA will result in the audit documentation being sufficient and appropriate in the circumstances. Other HKSA's contain specific documentation requirements that are intended to clarify the application of this HKSA in the particular circumstances of those other HKSA's. The specific documentation requirements of other HKSA's do not limit the application of this HKSA. Furthermore, the absence of a documentation requirement in any particular HKSA is not intended to suggest that there is no documentation that will be prepared as a result of complying with that HKSA.
- A7. Audit documentation provides evidence that the audit complies with the HKSA's. However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit. Further, it is unnecessary for the auditor to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included within the audit file. For example:
- The existence of an adequately documented audit plan demonstrates that the auditor has planned the audit.
 - The existence of a signed engagement letter in the audit file demonstrates that the auditor has agreed the terms of the audit engagement with management or, where appropriate, those charged with governance.
 - An auditor's report containing an appropriately qualified opinion on the financial statements demonstrates that the auditor has complied with the requirement to express a qualified opinion under the circumstances specified in the HKSA's.
 - In relation to requirements that apply generally throughout the audit, there may be a number of ways in which compliance with them may be demonstrated within the audit file:
 - For example, there may be no single way in which the auditor's professional skepticism is documented. But the audit documentation may nevertheless provide evidence of the auditor's exercise of professional skepticism in accordance with the HKSA's. For example, in relation to accounting estimates, when the audit evidence obtained includes evidence that both corroborates and contradicts management's assertions, documenting how the auditor evaluated that evidence, including the professional judgments made in forming a conclusion as to the sufficiency and appropriateness of the audit evidence obtained.

- Similarly, that the engagement partner has taken responsibility for the direction, supervision and performance of the audit in compliance with the HKSA's may be evidenced in a number of ways within the audit documentation. This may include documentation of the engagement partner's timely involvement in aspects of the audit, such as participation in the team discussions required by HKSA 315 (Revised).⁵

Documentation of Significant Matters and Related Significant Professional Judgments (Ref: Para. 8(c))

- A8. Judging the significance of a matter requires an objective analysis of the facts and circumstances. Examples of significant matters include:
- Matters that give rise to significant risks (as defined in HKSA 315 (Revised)).⁶
 - Results of audit procedures indicating (a) that the financial statements could be materially misstated, or (b) a need to revise the auditor's previous assessment of the risks of material misstatement and the auditor's responses to those risks.
 - Circumstances that cause the auditor significant difficulty in applying necessary audit procedures.
 - Findings that could result in a modification to the audit opinion or the inclusion of an Emphasis of Matter paragraph in the auditor's report.
- A9. An important factor in determining the form, content and extent of audit documentation of significant matters is the extent of professional judgment exercised in performing the work and evaluating the results. Documentation of the professional judgments made, where significant, serves to explain the auditor's conclusions and to reinforce the quality of the judgment. Such matters are of particular interest to those responsible for reviewing audit documentation, including those carrying out subsequent audits when reviewing matters of continuing significance (for example, when performing a retrospective review of accounting estimates).
- A10. Some examples of circumstances in which, in accordance with paragraph 8, it is appropriate to prepare audit documentation relating to the use of professional judgment include, where the matters and judgments are significant:
- The rationale for the auditor's conclusion when a requirement provides that the auditor "shall consider" certain information or factors, and that consideration is significant in the context of the particular engagement.
 - The basis for the auditor's conclusion on the reasonableness of areas of subjective judgments made by management.
 - The basis for the auditor's evaluation of whether an accounting estimate and related disclosures are reasonable in the context of the applicable financial reporting framework, or are misstated.
 - The basis for the auditor's conclusions about the authenticity of a document when further investigation (such as making appropriate use of an expert or of confirmation procedures) is undertaken in response to conditions identified during the audit that caused the auditor to believe that the document may not be authentic.
 - When HKSA 701 applies,⁷ the auditor's determination of the key audit matters or the determination that there are no key audit matters to be communicated.

⁵ HKSA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, paragraph 10

⁶ HKSA 315 (Revised), paragraph 4(e)

⁷ HKSA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

Appendix

(Ref: Para. 1)

Specific Audit Documentation Requirements in Other HKSAs

This appendix identifies paragraphs in other HKSAs that contain specific documentation requirements. The list is not a substitute for considering the requirements and related application and other explanatory material in HKSAs.

- HKSA 210, *Agreeing the Terms of Audit Engagements* – paragraphs 10-12
- HKSA 220, *Quality Control for an Audit of Financial Statements* – paragraphs 24-25
- HKSA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* – paragraphs 44-47
- HKSA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements* – paragraph 29; HKAS 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements* – paragraph 30
- HKSA 260 (Revised), *Communication with Those Charged with Governance* – paragraph 23
- HKSA 300, *Planning an Audit of Financial Statements* – paragraph 12
- HKSA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment* – paragraph 32
- HKSA 320, *Materiality in Planning and Performing an Audit* – paragraph 14
- HKSA 330, *The Auditor's Responses to Assessed Risks* – paragraphs 28-30
- HKSA 450, *Evaluation of Misstatements Identified during the Audit* – paragraph 15
- HKSA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures* – paragraph 39
- HKSA 550, *Related Parties* – paragraph 28
- HKSA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* – paragraph 50
- HKSA 610 (Revised 2013), *Using the Work of Internal Auditors* – paragraphs 36-37
- HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information* – paragraph 25

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Hong Kong Standard on Auditing 240

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



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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 January 2021, this HKSA conforms with International Standard on Auditing (ISA) 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* except that references to IESBA's 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 HKSA ensures compliance with ISA 240.
50. Additional local explanation is provided in footnote 11a, 25a and local guidance is provided in Appendix

^{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

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 (Revised).²⁰ That review is conducted as a risk assessment procedure to obtain information regarding the effectiveness of management's previous accounting estimates, audit evidence about the outcome, or where applicable, their subsequent re-estimation to assist in identifying and assessing the risks of material misstatement in the current period, 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 represent a risk of material misstatement due to fraud in accordance with this HKSA may be

²⁰ HKSA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

carried out in conjunction with the review required by HKSA 540 (Revised).

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, the reliability of evidence previously obtained may be called into question, since there may be

²¹ HKSA 330, paragraph 25

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 450²² 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 580²⁵ 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.

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*

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Consideration of Laws and Regulations in an Audit of Financial Statements



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Documentation

30. The auditor shall include in the audit documentation⁸ identified or suspected non-compliance with laws and regulations and: (Ref: Para. A35–A36)
- (a) The audit procedures performed, the significant professional judgments made and the conclusions reached thereon; and
 - (b) The discussions of significant matters related to the non-compliance with management, those charged with governance and others, including how management and, where applicable, those charged with governance have responded to the matter.

Conformity and Compliance with International Standards on Auditing

31. As of January 2021, this HKSA conforms with International Standard on Auditing (ISA) 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements* except that references to IESBA's 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 HKSA ensures compliance with ISA 250 (Revised). ISA 250 (Revised) has received the approval of the Public Interest Oversight Board (PIOB) which concluded that due process was followed in the development of the standard and that proper regard was paid to the public interest.
32. Additional local explanation is provided in footnotes 13a and 16a.

Application and Other Explanatory Material

Responsibility for Compliance with Laws and Regulations (Ref: Para. 3–9)

- A1. It is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity's operations are conducted in accordance with laws and regulations. Laws and regulations may affect an entity's financial statements in different ways: for example, most directly, they may affect specific disclosures required of the entity in the financial statements or they may prescribe the applicable financial reporting framework. They may also establish certain legal rights and obligations of the entity, some of which will be recognized in the entity's financial statements. In addition, laws and regulations may impose penalties in cases of non-compliance.
- A2. The following are examples of the types of policies and procedures an entity may implement to assist in the prevention and detection of non-compliance with laws and regulations:
- Monitoring legal requirements and ensuring that operating procedures are designed to meet these requirements.
 - Instituting and operating appropriate systems of internal control.
 - Developing, publicizing and following a code of conduct.
 - Ensuring employees are properly trained and understand the code of conduct.
 - Monitoring compliance with the code of conduct and acting appropriately to discipline employees who fail to comply with it.
 - Engaging legal advisors to assist in monitoring legal requirements.

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

HKSA 260 (Revised)
Issued August 2015; revised January 2016, June 2017,
January 2019, September 2019, July 2020, January 2021

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



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Certified Public Accountants
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Forms of Communication

19. The auditor shall communicate in writing with those charged with governance regarding significant findings from the audit if, in the auditor's professional judgment, oral communication 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 January 2021, this HKSA conforms with International Standard on Auditing (ISA) 260 (Revised), *Communication with Those Charged with Governance* except that references to IESBA's 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 HKSA ensures compliance with ISA 260 (Revised).
25. Additional local guidance is provided in footnotes 1a and 1b.

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

- The documents comprising the other information (as defined in HKSA 720 (Revised)) and the planned manner and timing of the issuance of such documents. When the auditor expects to obtain other information after the date of the auditor's report, the discussions with those charged with governance may also include the actions that may be appropriate or necessary if the auditor concludes that a material misstatement of the other information exists in other information obtained after the date of the auditor's report.

A15. While communication with those charged with governance may assist the auditor to plan the scope and timing of the audit, it does not change the auditor's sole responsibility to establish the overall audit strategy and the audit plan, including the nature, timing and extent of procedures necessary to obtain sufficient appropriate audit evidence.

A16. Care is necessary when communicating with those charged with governance about the planned scope and timing of the audit so as not to compromise the effectiveness of the audit, particularly where some or all of those charged with governance are involved in managing the entity. For example, communicating the nature and timing of detailed audit procedures may reduce the effectiveness of those procedures by making them too predictable.

Significant Findings from the Audit (Ref: Para. 16)

A17. The communication of findings from the audit may include requesting further information from those charged with governance in order to complete the audit evidence obtained. For example, the auditor may confirm that those charged with governance have the same understanding of the facts and circumstances relevant to specific transactions or events.

A18. When HKSA 701 applies, the communications with those charged with governance required by paragraph 16, as well as the communication about the significant risks identified by the auditor required by paragraph 15, are particularly relevant to the auditor's determination of matters that required significant auditor attention and which therefore may be key audit matters.¹¹

Significant Qualitative Aspects of Accounting Practices (Ref: Para. 16(a))

A19. Financial reporting frameworks ordinarily allow for the entity to make accounting estimates, and judgments about accounting policies and financial statement disclosures, for example, in relation to the use of assumptions in the development of accounting estimates. In addition, law, regulation or financial reporting frameworks may require disclosure of a summary of significant accounting policies or make reference to "critical accounting estimates" or "critical accounting policies and practices" to identify and provide additional information to users about the most difficult, subjective or complex judgments made by management in preparing the financial statements.

A20. As a result, the auditor's views on the subjective aspects of the financial statements may be particularly relevant to those charged with governance in discharging their responsibilities for oversight of the financial reporting process. For example, in relation to the matters described in paragraph A19, those charged with governance may be interested in the auditor's views on the degree to which complexity, subjectivity or other inherent risk factors affect the selection or application of the methods, assumptions and data used in making a significant accounting estimate, as well as the auditor's evaluation of whether management's point estimate and related disclosures in the financial statements are reasonable in the context of the applicable financial reporting framework. Open and constructive communication about significant qualitative aspects of the entity's accounting practices also may include comment on the acceptability of significant accounting practices and on the quality of the disclosures. When applicable, this may include whether a significant accounting practice of the entity relating to accounting estimates is considered by the auditor not to be most appropriate to the particular circumstances of the entity, for example, when an alternative acceptable method for making an accounting estimate would, in the auditor's judgment, be more appropriate. Appendix 2 identifies matters that may be included in this communication.

¹¹ HKSA 701, paragraphs 9–10

Appendix 1

(Ref: Para. 3)

Specific Requirements in HKSQC 1 and Other HKSA's that Refer to Communications with Those Charged With Governance

This appendix identifies paragraphs in HKSQC 1¹ and other HKSA's that require communication of specific matters with those charged with governance. The list is not a substitute for considering the requirements and related application and other explanatory material in HKSA's.

- HKSQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements* – paragraph 30(a)
- HKSA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* – paragraphs 22, 39(c)(i) and 41-43
- HKSA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements* – paragraphs 15, 20 and 23-25
- HKSA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management* – paragraph 9
- HKSA 450, *Evaluation of Misstatements Identified during the Audit* – paragraphs 12-13
- HKSA 505, *External Confirmations* – paragraph 9
- HKSA 510, *Initial Audit Engagements—Opening Balances* – paragraph 7
- HKSA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures* – paragraph 38
- HKSA 550, *Related Parties* – paragraph 27
- HKSA 560, *Subsequent Events* – paragraphs 7(b)-(c), 10(a), 13(b), 14(a) and 17
- HKSA 570 (Revised), *Going Concern* – paragraph 25
- HKSA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* – paragraph 49
- HKSA 610 (Revised 2013), *Using the Work of Internal Auditors* – paragraphs 20 and 31
- HKSA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements* – paragraph 46
- HKSA 701, *Communicating Key Audit Matters in the Independent Auditor's Report* – paragraph 17
- HKSA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report* – paragraphs 12, 14, 23 and 30
- HKSA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report* – paragraph 12
- HKSA 710, *Comparative Information—Corresponding Figures and Comparative Financial Statements* – paragraph 18

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

Appendix 2

(Ref: Para. 16(a), A19–A20)

Qualitative Aspects of Accounting Practices

The communication required by paragraph 16(a), and discussed in paragraphs A19–A20, may include such matters as:

Accounting Policies

- The appropriateness of the accounting policies to the particular circumstances of the entity, having regard to the need to balance the cost of providing information with the likely benefit to users of the entity's financial statements. Where acceptable alternative accounting policies exist, the communication may include identification of the financial statement items that are affected by the choice of significant accounting policies as well as information on accounting policies used by similar entities.
- The initial selection of, and changes in, significant accounting policies, including the application of new accounting pronouncements. The communication may include: the effect of the timing and method of adoption of a change in accounting policy on the current and future earnings of the entity; and the timing of a change in accounting policies in relation to expected new accounting pronouncements.
- The effect of significant accounting policies in controversial or emerging areas (or those unique to an industry, particularly when there is a lack of authoritative guidance or consensus).
- The effect of the timing of transactions in relation to the period in which they are recorded.

Accounting Estimates and Related Disclosures

- Appendix 2 of HKSA 540 (Revised) includes matters that the auditor may consider communicating with respect to significant qualitative aspects of the entity's accounting practices related to accounting estimates and related disclosures.

Financial Statement Disclosures

- The issues involved, and related judgments made, in formulating particularly sensitive financial statement disclosures (e.g., disclosures related to revenue recognition, remuneration, going concern, subsequent events, and contingency issues).
- The overall neutrality, consistency and clarity of the disclosures in the financial statements.

Related Matters

- The potential effect on the financial statements of significant risks, exposures and uncertainties, such as pending litigation, that are disclosed in the financial statements.
- The extent to which the financial statements are affected by significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual. This communication may highlight:
 - The non-recurring amounts recognized during the period.
 - The extent to which such transactions are separately disclosed in the financial statements.
 - Whether such transactions appear to have been designed to achieve a particular accounting or tax treatment, or a particular legal or regulatory objective.

COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

- Whether the form of such transactions appears overly complex or where extensive advice regarding the structuring of the transaction has been taken.
- Where management is placing more emphasis on the need for a particular accounting treatment than on the underlying economics of the transaction.
- The factors affecting asset and liability carrying values, including the entity's bases for determining useful lives assigned to tangible and intangible assets. The communication may explain how factors affecting carrying values were selected and how alternative selections would have affected the financial statements.
- The selective correction of misstatements, for example, correcting misstatements with the effect of increasing reported earnings, but not those that have the effect of decreasing reported earnings.

HKSA 315 (Revised 2019)
Issued March 2020; revised January 2021

Effective for audits of financial statements
for periods beginning on or after 15 December 2021

Hong Kong Standard on Auditing 315 (Revised 2019)

Identifying and Assessing the Risks of Material Misstatement and Conforming and Consequential Amendments to Other Hong Kong Standards Arising from HKSA 315 (Revised 2019)



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Revision of Risk Assessment

37. If the auditor obtains new information which is inconsistent with the audit evidence on which the auditor originally based the identification or assessments of the risks of material misstatement, the auditor shall revise the identification or assessment. (Ref: Para. A236)

Documentation

38. The auditor shall include in the audit documentation:¹³ (Ref: Para. A237–A241)
- (a) The discussion among the engagement team and the significant decisions reached;
 - (b) Key elements of the auditor's understanding in accordance with paragraphs 19, 21, 22, 24 and 25; the sources of information from which the auditor's understanding was obtained; and the risk assessment procedures performed;
 - (c) The evaluation of the design of identified controls, and determination whether such controls have been implemented, in accordance with the requirements in paragraph 26; and
 - (d) The identified and assessed risks of material misstatement at the financial statement level and at the assertion level, including significant risks and risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence, and the rationale for the significant judgments made.

Conformity and Compliance with International Standards on Auditing

39. As of January 2021, this HKSA conforms with International Standard on Auditing (ISA) 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*. Compliance with the requirements of this HKSA ensures compliance with ISA 315 (Revised 2019).

Application and Other Explanatory Material**Definitions** (Ref: Para. 12)*Assertions* (Ref: Para. 12(a))

- A1. Categories of assertions are used by auditors to consider the different types of potential misstatements that may occur when identifying, assessing and responding to the risks of material misstatement. Examples of these categories of assertions are described in paragraph A190. The assertions differ from the written representations required by HKSA 580,¹⁴ to confirm certain matters or support other audit evidence.

Controls (Ref: Para. 12(c))

- A2. Controls are embedded within the components of the entity's system of internal control.
- A3. Policies are implemented through the actions of personnel within the entity, or through the restraint of personnel from taking actions that would conflict with such policies.

¹³ HKSA 230, *Audit Documentation*, paragraphs 8–11, and A6–A7

¹⁴ HKSA 580, *Written Representations*

- A18. The nature and extent of risk assessment procedures to be performed the first time an engagement is undertaken may be more extensive than procedures for a recurring engagement. In subsequent periods, the auditor may focus on changes that have occurred since the preceding period.

Types of Risk Assessment Procedures (Ref: Para. 14)

- A19. HKSA 500²¹ explains the types of audit procedures that may be performed in obtaining audit evidence from risk assessment procedures and further audit procedures. The nature, timing and extent of the audit procedures may be affected by the fact that some of the accounting data and other evidence may only be available in electronic form or only at certain points in time.²² The auditor may perform substantive procedures or tests of controls, in accordance with HKSA 330, concurrently with risk assessment procedures, when it is efficient to do so. Audit evidence obtained that supports the identification and assessment of risks of material misstatement may also support the detection of misstatements at the assertion level or the evaluation of the operating effectiveness of controls.
- A20. Although the auditor is required to perform all the risk assessment procedures described in paragraph 14 in the course of obtaining the required understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control (see paragraphs 19–26), the auditor is not required to perform all of them for each aspect of that understanding. Other procedures may be performed when the information to be obtained may be helpful in identifying risks of material misstatement. Examples of such procedures may include making inquiries of the entity's external legal counsel or external supervisors, or of valuation experts that the entity has used.

Automated Tools and Techniques (Ref: Para. 14)

- A21. Using automated tools and techniques, the auditor may perform risk assessment procedures on large volumes of data (from the general ledger, sub-ledgers or other operational data) including for analysis, recalculations, reperformance or reconciliations.

Inquiries of Management and Others within the Entity (Ref: Para. 14(a))

Why Inquiries Are Made of Management and Others Within the Entity

- A22. Information obtained by the auditor to support an appropriate basis for the identification and assessment of risks, and the design of further audit procedures, may be obtained through inquiries of management and those responsible for financial reporting.
- A23. Inquiries of management and those responsible for financial reporting and of other appropriate individuals within the entity and other employees with different levels of authority may offer the auditor varying perspectives when identifying and assessing risks of material misstatement.

²¹ HKSA 500, paragraphs A18–A21 and A25–A29

²² HKSA 500, paragraph A16

Assessing Control Risk (Ref: Para. 34)

A226. The auditor's plans to test the operating effectiveness of controls is based on the expectation that controls are operating effectively, and this will form the basis of the auditor's assessment of control risk. The initial expectation of the operating effectiveness of controls is based on the auditor's evaluation of the design, and the determination of implementation, of the identified controls in the control activities component. Once the auditor has tested the operating effectiveness of the controls in accordance with HKSA 330, the auditor will be able to confirm the initial expectation about the operating effectiveness of controls. If the controls are not operating effectively as expected, then the auditor will need to revise the control risk assessment in accordance with paragraph 37.

A227. The auditor's assessment of control risk may be performed in different ways depending on preferred audit techniques or methodologies, and may be expressed in different ways.

A228. If the auditor plans to test the operating effectiveness of controls, it may be necessary to test a combination of controls to confirm the auditor's expectation that the controls are operating effectively. The auditor may plan to test both direct and indirect controls, including general IT controls, and, if so, take into account the combined expected effect of the controls when assessing control risk. To the extent that the control to be tested does not fully address the assessed inherent risk, the auditor determines the implications on the design of further audit procedures to reduce audit risk to an acceptably low level.

A229. When the auditor plans to test the operating effectiveness of an automated control, the auditor may also plan to test the operating effectiveness of the relevant general IT controls that support the continued functioning of that automated control to address the risks arising from the use of IT, and to provide a basis for the auditor's expectation that the automated control operated effectively throughout the period. When the auditor expects related general IT controls to be ineffective, this determination may affect the auditor's assessment of control risk at the assertion level and the auditor's further audit procedures may need to include substantive procedures to address the applicable risks arising from the use of IT. Further guidance about the procedures that the auditor may perform in these circumstances is provided in HKSA 330.⁶¹

Evaluating the Audit Evidence Obtained from the Risk Assessment Procedures (Ref: Para 35)

Why the Auditor Evaluates the Audit Evidence from the Risk Assessment Procedures

A230. Audit evidence obtained from performing risk assessment procedures provides the basis for the identification and assessment of the risks of material misstatement. This provides the basis for the auditor's design of the nature, timing and extent of further audit procedures responsive to the assessed risks of material misstatement, at the assertion level, in accordance with HKSA 330. Accordingly, the audit evidence obtained from the risk assessment procedures provides a basis for the identification and assessment of risks of material misstatement whether due to fraud or error, at the financial statement and assertion levels.

The Evaluation of the Audit Evidence

A231. Audit evidence from risk assessment procedures comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions.⁶²

⁶¹ HKSA 330, paragraphs A29–A30

⁶² HKSA 500, paragraph A5

HKSA 500
Issued July 2009; revised July 2010, May 2013,
February 2015, August 2015, June 2017, January 2019,
January 2021

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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)

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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 520³), and the evaluation of whether sufficient appropriate audit evidence has been obtained (HKSA 200⁴ and HKSA 330⁵).

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 this HKSA, 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.

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) External information source – An external individual or organization that provides information that has been used by the entity in preparing the financial statements, or that has been obtained by the auditor as audit evidence, when such information is suitable for use by a broad range of users. When information has been provided by an individual or organization acting in the capacity of a management's expert, service organization⁶, or auditor's expert⁷ the individual or organization is not considered an external information source with respect to that particular information. (Ref: Para. A1-A4)
- (e) 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.
- (f) 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. A5-A29)

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, including information obtained from an external information source. (Ref: Para. A30-A44)
- 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. A45-A47)
 - (a) Evaluate the competence, capabilities and objectivity of that expert; (Ref: Para. A48-A54)
 - (b) Obtain an understanding of the work of that expert; and (Ref: Para. A55-A58)
 - (c) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion. (Ref: Para. A59)
- 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. A60-A61)

⁶ HKSA 402, *Audit Considerations Relating to an Entity Using a Service Organization*, paragraph 8.

⁷ HKSA 620, *Using the Work of an Auditor's Expert*, paragraph 6

- (b) Evaluating whether the information is sufficiently precise and detailed for the auditor's purposes. (Ref: Para. A62)

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. A63-A67)

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. A68)

Conformity and Compliance with International Standards on Auditing

12. As of January 2021, this HKSA conforms with International Standard on Auditing (ISA) 500, *Audit Evidence*. Compliance with the requirements of this HKSA ensures compliance with ISA 500.

Application and Other Explanatory Material

External Information Source (Ref: Para 5(d))

- A1. External information sources may include pricing services, governmental organizations, central banks or recognized stock exchanges. Examples of information that may be obtained from external information sources include:
- Prices and pricing related data;
 - Macro-economic data, such as historical and forecast unemployment rates and economic growth rates, or census data;
 - Credit history data;
 - Industry specific data, such as an index of reclamation costs for certain extractive industries, or viewership information or ratings used to determine advertising revenue in the entertainment industry; and
 - Mortality tables used to determine liabilities in the life insurance and pension sectors.

- A2. A particular set of information is more likely to be suitable for use by a broad range of users and less likely to be subject to influence by any particular user if the external individual or organization provides it to the public for free, or makes it available to a wide range of users in return for payment of a fee. Judgment may be required in determining whether the information is suitable for use by a broad range of users, taking into account the ability of the entity to influence the external information source.
- A3. An external individual or organization cannot, in respect of any particular set of information, be both an external information source and a management's expert, or service organization or auditor's expert.
- A4. However, an external individual or organization may, for example, be acting as a management's expert when providing a particular set of information, but may be acting as an external information source when providing a different set of information. In some circumstances, professional judgment may be needed to determine whether an external individual or organization is acting as an external information source or as a management's expert with respect to a particular set of information. In other circumstances, the distinction may be clear. For example:
- An external individual or organization may be providing information about real estate prices that is suitable for use by a broad range of users, for example, information made generally available pertaining to a geographical region, and be determined to be an external information source with respect to that set of information. The same external organization may also be acting as a management's or auditor's expert in providing commissioned valuations, with respect to the entity's real estate portfolio specifically tailored for the entity's facts and circumstances.
 - Some actuarial organizations publish mortality tables for general use which, when used by an entity, would generally be considered to be information from an external information source. The same actuarial organization may also be a management's expert with respect to different information tailored to the specific circumstances of the entity to help management determine the pension liability for several of the entity's pension plans.
 - An external 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 external individual or organization applies that expertise in making an estimate specifically for the entity and that work is used by management in preparing its financial statements, the external individual or organization is likely to be a management's expert with respect to that information. If, on the other hand, that external individual or organization merely provides, to the public, prices or pricing-related data regarding private transactions, and the entity uses that information in its own estimation methods, the external individual or organization is likely to be an external information source with respect to such information.
 - An external individual or organization may publish information, suitable for a broad range of users, about risks or conditions in an industry. If used by an entity in preparing its risk disclosures (for example in compliance with HKFRS 7⁸), such information would ordinarily be considered to be information from an external information source. However, if the same type of information has been specifically commissioned by the entity to use its expertise to develop information about those risks, tailored to the entity's circumstances, the external individual or organization is likely to be acting as a management's expert.

⁸ Hong Kong Financial Reporting Standards 7 (HKFRS), *Financial Instruments: Disclosures*

- An external individual or organization may apply its expertise in providing information about current and future market trends, which it makes available to, and is suitable for use by, a broad range of users. If used by the entity to help make decisions about assumptions to be used in making accounting estimates, such information is likely to be considered to be information from an external information source. If the same type of information has been commissioned by the entity to address current and future trends relevant to the entity's specific facts and circumstances, the external individual or organization is likely to be acting as a management's expert.

Sufficient Appropriate Audit Evidence (Ref: Para. 6)

- A5. 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 audit⁹) or a firm's quality control procedures for client acceptance and continuance. In addition, the entity's accounting records and other sources internal to the entity are important sources of audit evidence. Information that may be used as audit evidence may have been prepared using the work of a management's expert or be obtained from an external information source. 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.
- A6. 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.
- A7. As explained in HKSA 200,¹⁰ 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.
- A8. 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.
- A9. 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.

⁹ HKSA 315 (Revised), paragraph 9

¹⁰ HKSA 200, paragraph 5

- A10. HKSA 330 requires the auditor to conclude whether sufficient appropriate audit evidence has been obtained.¹¹ 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

- A11. 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.
- A12. 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.
- A13. Information from sources independent of the entity that the auditor may use as audit evidence may include confirmations from third parties and information from an external information source, including analysts' reports, and comparable data about competitors (benchmarking data).

Audit Procedures for Obtaining Audit Evidence

- A14. 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
 - (ii) Substantive procedures, including tests of details and substantive analytical procedures.

¹¹ HKSA 330, paragraph 26

- A15. The audit procedures described in paragraphs A18-A29 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.¹²
- A16. 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.
- A17. 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

- A18. 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.
- A19. 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.
- A20. 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

- A21. 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.¹³

¹² HKSA 330, paragraph A35

¹³ HKSA 501, *Audit Evidence—Specific Considerations for Selected Items*

External Confirmation

A22. 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.¹⁴

Recalculation

A23. Recalculation consists of checking the mathematical accuracy of documents or records. Recalculation may be performed manually or electronically.

Reperformance

A24. Repformance involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control.

Analytical Procedures

A25. 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

A26. 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.

A27. 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.

¹⁴ HKSA 505, *External Confirmations*

- A28. 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 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.
- A29. 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.¹⁵

Information to Be Used as Audit Evidence

Relevance and Reliability (Ref: Para. 7)

- A30. As noted in paragraph A5, 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

- A31. 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.
- A32. 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.
- A33. 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.

¹⁵ HKSA 580, *Written Representations*

- A34. 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.

Reliability

- A35. 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 a source independent of the entity 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.

- A36. HKSA 520 provides further guidance regarding the reliability of data used for purposes of designing analytical procedures as substantive procedures.¹⁶

- A37. 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.¹⁷

¹⁶ HKSA 520, paragraph 5(a)

¹⁷ HKSA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, paragraph 13

A38. HKSA 250 (Revised)¹⁸ 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.

External Information Sources

A39. The auditor is required by paragraph 7 to consider the relevance and reliability of information obtained from an external information source that is to be used as audit evidence, regardless of whether that information has been used by the entity in preparing the financial statements or obtained by the auditor. For information obtained from an external information source, that consideration may, in certain cases, include audit evidence about the external information source or the preparation of the information by the external information source, obtained through designing and performing further audit procedures in accordance with HKSA 330 or, where applicable, HKSA 540 (Revised).¹⁹

A40. Obtaining an understanding of why management or, when applicable, a management's expert uses an external information source, and how the relevance and reliability of the information was considered (including its accuracy and completeness), may help to inform the auditor's consideration of the relevance and reliability of that information.

A41. The following factors may be important when considering the relevance and reliability of information obtained from an external information source, including its accuracy and completeness, taking into account that some of these factors may only be relevant when the information has been used by management in preparing the financial statements or has been obtained by the auditor:

- The nature and authority of the external information source. For example, a central bank or government statistics office with a legislative mandate to provide industry information to the public is likely to be an authority for certain types of information;
- The ability to influence the information obtained, through relationships between the entity and the information source;
- The competence and reputation of the external information source with respect to the information, including whether, in the auditor's professional judgment, the information is routinely provided by a source with a track record of providing reliable information;
- Past experience of the auditor with the reliability of the information provided by the external information source;
- Evidence of general market acceptance by users of the relevance and/or reliability of information from an external information source for a similar purpose to that for which the information has been used by management or the auditor;
- Whether the entity has in place controls to address the relevance and reliability of the information obtained and used;
- Whether the external information source accumulates overall market information or engages directly in "setting" market transactions;

¹⁸ HKSA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*, paragraph 9

¹⁹ HKSA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

- Whether the information is suitable for use in the manner in which it is being used and, if applicable, was developed taking into account the applicable financial reporting framework;
- Alternative information that may contradict the information used;
- The nature and extent of disclaimers or other restrictive language relating to the information obtained;
- Information about the methods used in preparing the information, how the methods are being applied including, where applicable, how models have been used in such application, and the controls over the methods; and
- When available, information relevant to considering the appropriateness of assumptions and other data applied by the external information sources in developing the information obtained.

A42. The nature and extent of the auditor's consideration takes into account the assessed risks of material misstatement at the assertion level to which the use of the external information is relevant, the degree to which the use of that information is relevant to the reasons for the assessed risks of material misstatement and the possibility that the information from the external information source may not be reliable (for example, whether it is from a credible source). Based on the auditor's consideration of the matters described in paragraph A39, the auditor may determine that further understanding of the entity and its environment, including its internal control, is needed, in accordance with HKSA 315, or that further audit procedures, in accordance with HKSA 330²⁰, and HKSA 540 (Revised)²¹ when applicable, are appropriate in the circumstances, to respond to the assessed risks of material misstatement related to the use of information from an external information source. Such procedures may include:

- Performing a comparison of information obtained from the external information source with information obtained from an alternative independent information source.
- When relevant to considering management's use of an external information source, obtaining an understanding of controls management has in place to consider the reliability of the information from external information sources, and potentially testing the operating effectiveness of such controls.
- Performing procedures to obtain information from the external information source to understand its processes, techniques, and assumptions, for the purposes of identifying, understanding and, when relevant, testing the operating effectiveness of its controls.

²⁰ HKSA 330, paragraph 6

²¹ HKSA 540 (Revised), paragraph 30

- A43. In some situations, there may be only one provider of certain information, for example, information from a central bank or government, such as an inflation rate, or a single recognized industry body. In such cases, the auditor's determination of the nature and extent of audit procedures that may be appropriate in the circumstances is influenced by the nature and credibility of the source of the information, the assessed risks of material misstatement to which that external information is relevant, and the degree to which the use of that information is relevant to the reasons for the assessed risk of material misstatement. For example, when the information is from a credible authoritative source, the extent of the auditor's further audit procedures may be less extensive, such as corroborating the information to the source's website or published information. In other cases, if a source is not assessed as credible, the auditor may determine that more extensive procedures are appropriate and, in the absence of any alternative independent information source against which to compare, may consider whether performing procedures to obtain information from the external information source, when practical, is appropriate in order to obtain sufficient appropriate audit evidence.
- A44. When the auditor does not have a sufficient basis with which to consider the relevance and reliability of information from an external information source, the auditor may have a limitation on scope if sufficient appropriate audit evidence cannot be obtained through alternative procedures. Any imposed limitation on scope is evaluated in accordance with the requirements of HKSA 705 (Revised).²²

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

- A45. 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.
- A46. 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 being information from an external information source and not the use of a management's expert by the entity.
- A47. 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.

²² HKSA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*, paragraph 13

- 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))

- A48. Competence relates to the nature and level of expertise of the management's expert. Capability relates to 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.
- A49. 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.
- A50. 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.

A51. 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.

A52. 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).

A53. 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.

A54. 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))

A55. 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.²³

²³ HKSA 620, paragraph 7

A56. 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.

A57. 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.

A58. 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.

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

A59. 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;
- If that expert's work involves significant use of source data, the relevance, completeness, and accuracy of that source data; and
- If that expert's work involves the use of information from an external information source, the relevance and reliability of that information.

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

- A60. 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.
- A61. 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.
- A62. 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)

- A63. 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

- A64. 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

A65. 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.

A66. 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

A67. 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 530.²⁴

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

A68. 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.²⁵

²⁴ HKSA 530, *Audit Sampling*

²⁵ HKSA 230, *Audit Documentation*, paragraph 11

HKSA 505
Issued June 2010, revised January 2021

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

Hong Kong Standard on Auditing 505

External Confirmations



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Introduction

Scope of this HKSA

1. This Hong Kong Standard on Auditing (HKSA) deals with the auditor's use of external confirmation procedures to obtain audit evidence in accordance with the requirements of HKSA 330¹ and HKSA 500.² It does not address inquiries regarding litigation and claims, which are dealt with in HKSA 501³.

External Confirmation Procedures to Obtain Audit Evidence

2. HKSA 500 indicates that the reliability of audit evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.⁴ That HKSA also includes the following generalizations applicable to audit evidence:⁵
 - Audit evidence is more reliable when it is obtained from independent sources outside the entity.
 - Audit evidence obtained directly by the auditor is more reliable than audit evidence obtained indirectly or by inference.
 - Audit evidence is more reliable when it exists in documentary form, whether paper, electronic or other medium.

Accordingly, depending on the circumstances of the audit, audit evidence in the form of external confirmations received directly by the auditor from confirming parties may be more reliable than evidence generated internally by the entity. This HKSA is intended to assist the auditor in designing and performing external confirmation procedures to obtain relevant and reliable audit evidence.

3. Other HKSAs recognize the importance of external confirmations as audit evidence, for example:
 - HKSA 330 discusses the auditor's responsibility to design and implement overall responses to address the assessed risks of material misstatement at the financial statement level, and to design and perform further audit procedures whose nature, timing and extent are based on, and are responsive to, the assessed risks of material misstatement at the assertion level.⁶ In addition, HKSA 330 requires that, irrespective of the assessed risks of material misstatement, the auditor designs and performs substantive procedures for each material class of transactions, account balance, and disclosure. The auditor is also required to consider whether external confirmation procedures are to be performed as substantive audit procedures.⁷
 - HKSA 330 requires that the auditor obtain more persuasive audit evidence the higher the auditor's assessment of risk.⁸ To do this, the auditor may increase the quantity of

¹ HKSA 330, "The Auditor's Responses to Assessed Risks."

² HKSA 500, "Audit Evidence."

³ HKSA 501, "Audit Evidence—Specific Considerations for Selected Items."

⁴ HKSA 500, paragraph A9.

⁵ HKSA 500, paragraph A35.

⁶ HKSA 330, paragraphs 5-6.

⁷ HKSA 330, paragraphs 18-19.

⁸ HKSA 330, paragraph 7(b).

the evidence or obtain evidence that is more relevant or reliable, or both. For example, the auditor may place more emphasis on obtaining evidence directly from third parties or obtaining corroborating evidence from a number of independent sources. HKSA 330 also indicates that external confirmation procedures may assist the auditor in obtaining audit evidence with the high level of reliability that the auditor requires to respond to significant risks of material misstatement, whether due to fraud or error.⁹

- HKSA 240 indicates that the auditor may design confirmation requests to obtain additional corroborative information as a response to address the assessed risks of material misstatement due to fraud at the assertion level.¹⁰
- HKSA 500 indicates that corroborating information obtained from a source independent of the entity, such as external confirmations, may increase the assurance the auditor obtains from evidence existing within the accounting records or from representations made by management.¹¹

Effective Date

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

Objective

5. The objective of the auditor, when using external confirmation procedures, is to design and perform such procedures to obtain relevant and reliable audit evidence.

Definitions

6. For purposes of the HKSAs, the following terms have the meanings attributed below:
 - (a) External confirmation – Audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium.
 - (b) Positive confirmation request – A request that the confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request, or providing the requested information.
 - (c) Negative confirmation request – A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.
 - (d) Non-response – A failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered.
 - (e) Exception – A response that indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party.

⁹ HKSA 330, paragraph A53.

¹⁰ HKSA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements," paragraph A37.

¹¹ HKSA 500, paragraphs A12-A13.

Non-Responses

12. In the case of each non-response, the auditor shall perform alternative audit procedures to obtain relevant and reliable audit evidence. (Ref: Para A18-A19)

When a Response to a Positive Confirmation Request Is Necessary to Obtain Sufficient Appropriate Audit Evidence

13. If the auditor has determined that a response to a positive confirmation request is necessary to obtain sufficient appropriate audit evidence, alternative audit procedures will not provide the audit evidence the auditor requires. If the auditor does not obtain such confirmation, the auditor shall determine the implications for the audit and the auditor's opinion in accordance with HKSA 705. (Ref: Para A20)

Exceptions

14. The auditor shall investigate exceptions to determine whether or not they are indicative of misstatements. (Ref: Para. A21-A22)

Negative Confirmations

15. Negative confirmations provide less persuasive audit evidence than positive confirmations. Accordingly, the auditor shall not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level unless all of the following are present: (Ref: Para. A23)
 - (a) The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion;
 - (b) The population of items subject to negative confirmation procedures comprises a large number of small, homogeneous account balances, transactions or conditions;
 - (c) A very low exception rate is expected; and
 - (d) The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests.

Evaluating the Evidence Obtained

16. The auditor shall evaluate whether the results of the external confirmation procedures provide relevant and reliable audit evidence, or whether further audit evidence is necessary. (Ref: Para A24-A25)

Conformity and Compliance with International Standards on Auditing

17. As of January 2021, this HKSA conforms with International Standard on Auditing (ISA) 505 "External Confirmations". Compliance with the requirements of this HKSA ensures compliance with ISA 505.
18. Additional local requirement and guidance are provided in Appendix 1. A standard bank confirmation request form is reproduced in Appendix 2.

- A6. Determining that requests are properly addressed includes testing the validity of some or all of the addresses on confirmation requests before they are sent out.

Follow-Up on Confirmation Requests (Ref: Para. 7(d))

- A7. The auditor may send an additional confirmation request when a reply to a previous request has not been received within a reasonable time. For example, the auditor may, having re-verified the accuracy of the original address, send an additional or follow-up request.

Management's Refusal to Allow the Auditor to Send a Confirmation Request

Reasonableness of Management's Refusal (Ref: Para. 8(a))

- A8. A refusal by management to allow the auditor to send a confirmation request is a limitation on the audit evidence the auditor may wish to obtain. The auditor is therefore required to inquire as to the reasons for the limitation. A common reason advanced is the existence of a legal dispute or ongoing negotiation with the intended confirming party, the resolution of which may be affected by an untimely confirmation request. The auditor is required to seek audit evidence as to the validity and reasonableness of the reasons because of the risk that management may be attempting to deny the auditor access to audit evidence that may reveal fraud or error.

Implications for the Assessment of Risks of Material Misstatement (Ref: Para. 8(b))

- A9. The auditor may conclude from the evaluation in paragraph 8(b) that it would be appropriate to revise the assessment of the risks of material misstatement at the assertion level and modify planned audit procedures in accordance with HKSA 315.¹⁴ For example, if management's request to not confirm is unreasonable, this may indicate a fraud risk factor that requires evaluation in accordance with HKSA 240.¹⁵

Alternative Audit Procedures (Ref: Para. 8(c))

- A10. The alternative audit procedures performed may be similar to those appropriate for a non-response as set out in paragraphs A18-A19 of this HKSA. Such procedures also would take account of the results of the auditor's evaluation in paragraph 8(b) of this HKSA.

Results of the External Confirmation Procedures

Reliability of Responses to Confirmation Requests (Ref: Para. 10)

- A11. HKSA 500 indicates that even when audit evidence is obtained from sources external to the entity, circumstances may exist that affect its reliability.¹⁶ All responses carry some risk of interception, alteration or fraud. Such risk exists regardless of whether a response is obtained in paper form, or by electronic or other medium. Factors that may indicate doubts about the reliability of a response include that it:

- Was received by the auditor indirectly; or
- Appeared not to come from the originally intended confirming party.

¹⁴ HKSA 315, "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment," paragraph 31.

¹⁵ HKSA 240, paragraph 24.

¹⁶ HKSA 500, paragraph A35.

HKSA 520
Issued July 2009; revised January 2021

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

Hong Kong Standard on Auditing 520

Analytical Procedures



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- (b) Evaluate the reliability of data from which the auditor's expectation of recorded amounts or ratios is developed, taking account of source, comparability, and nature and relevance of information available, and controls over preparation; (Ref: Para. A12-A14)
- (c) Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated; and (Ref: Para. A15)
- (d) Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation as required by paragraph 7. (Ref: Para. A16)

Analytical Procedures that Assist When Forming an Overall Conclusion

- 6. The auditor shall design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity. (Ref: Para. A17-A19)

Investigating Results of Analytical Procedures

- 7. If analytical procedures performed in accordance with this HKSA identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by:
 - (a) Inquiring of management and obtaining appropriate audit evidence relevant to management's responses; and
 - (b) Performing other audit procedures as necessary in the circumstances. (Ref: Para. A20-A21)

Conformity and Compliance with International Standards on Auditing

- 8. As of January 2021, this HKSA conforms with International Standard on Auditing (ISA) 520 "Analytical Procedures". Compliance with the requirements of this HKSA ensures compliance with ISA 520.

Application and Other Explanatory Material

Definition of Analytical Procedures (Ref: Para. 4)

- A1. Analytical procedures include the consideration of comparisons of the entity's financial information with, for example:
 - Comparable information for prior periods.
 - Anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation.
 - Similar industry information, such as a 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.

- A9. The determination of the suitability of particular substantive analytical procedures is influenced by the nature of the assertion and the auditor's assessment of the risk of material misstatement. For example, if controls over sales order processing are deficient, the auditor may place more reliance on tests of details rather than on substantive analytical procedures for assertions related to receivables.
- A10. Particular substantive analytical procedures may also be considered suitable when tests of details are performed on the same assertion. For example, when obtaining audit evidence regarding the valuation assertion for accounts receivable balances, the auditor may apply analytical procedures to an aging of customers' accounts in addition to performing tests of details on subsequent cash receipts to determine the collectability of the receivables.

Considerations Specific to Public Sector Entities

- A11. The relationships between individual financial statement items traditionally considered in the audit of business entities may not always be relevant in the audit of governments or other non-business public sector entities; for example, in many public sector entities there may be little direct relationship between revenue and expenditure. In addition, because expenditure on the acquisition of assets may not be capitalized, there may be no relationship between expenditures on, for example, inventories and fixed assets and the amount of those assets reported in the financial statements. Also, industry data or statistics for comparative purposes may not be available in the public sector. However, other relationships may be relevant, for example, variations in the cost per kilometer of road construction or the number of vehicles acquired compared with vehicles retired.

The Reliability of the Data (Ref: Para. 5(b))

- A12. The reliability of data is influenced by its source and nature and is dependent on the circumstances under which it is obtained. Accordingly, the following are relevant when determining whether data is reliable for purposes of designing substantive analytical procedures:
- (a) Source of the information available. For example, information may be more reliable when it is obtained from independent sources outside the entity;⁴
 - (b) Comparability of the information available. For example, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialized products;
 - (c) Nature and relevance of the information available. For example, whether budgets have been established as results to be expected rather than as goals to be achieved; and
 - (d) Controls over the preparation of the information that are designed to ensure its completeness, accuracy and validity. For example, controls over the preparation, review and maintenance of budgets.
- A13. The auditor may consider testing the operating effectiveness of controls, if any, over the entity's preparation of information used by the auditor in performing substantive analytical procedures in response to assessed risks. When such controls are effective, the auditor generally has greater confidence in the reliability of the information and, therefore, in the results of analytical procedures. The operating effectiveness of controls over non-financial information may often be tested in conjunction with other tests of controls. For example, in establishing controls over the processing of sales invoices, an entity may include controls over the recording of unit sales. In these circumstances, the auditor may test the operating

⁴ HKSA 500, "Audit Evidence," paragraph A35.

HKSA 540 (Revised)
Issued December 2018, revised January 2021

Effective for audits of financial statements for periods
beginning on or after 15 December 2019

Hong Kong Standard on Auditing 540 (Revised)

Auditing Accounting Estimates and Related Disclosures



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- (b) The linkage of the auditor's further audit procedures with the assessed risks of material misstatement at the assertion level,²⁹ taking into account the reasons (whether related to inherent risk or control risk) given to the assessment of those risks;
- (c) The auditor's response(s) when management has not taken appropriate steps to understand and address estimation uncertainty;
- (d) Indicators of possible management bias related to accounting estimates, if any, and the auditor's evaluation of the implications for the audit, as required by paragraph 32; and
- (e) Significant judgments relating to the auditor's determination of whether the accounting estimates and related disclosures are reasonable in the context of the applicable financial reporting framework, or are misstated.

Conformity and Compliance with International Standards on Auditing

40. As of January 2021, this HKSA conforms with International Standard on Auditing (ISA) 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*. Compliance with the requirements of this HKSA ensures compliance with ISA 540 (Revised).

* * *

Application and Other Explanatory Material

Nature of Accounting Estimates (Ref: Para. 2)

Examples of Accounting Estimates

- A1. Examples of accounting estimates related to classes of transactions, account balances and disclosures include:
- Inventory obsolescence.
 - Depreciation of property and equipment.
 - Valuation of infrastructure assets.
 - Valuation of financial instruments.
 - Outcome of pending litigation.
 - Provision for expected credit losses.
 - Valuation of insurance contract liabilities.
 - Warranty obligations.
 - Employee retirement benefits liabilities.
 - Share-based payments.
 - Fair value of assets or liabilities acquired in a business combination, including the determination of goodwill and intangible assets.
 - Impairment of long-lived assets or property or equipment held for disposal.
 - Non-monetary exchanges of assets or liabilities between independent parties.
 - Revenue recognized for long-term contracts.

Methods

- A2. A method is a measurement technique used by management to make an accounting estimate in accordance with the required measurement basis. For example, one recognized method used to make accounting estimates relating to share-based payment transactions is to determine a theoretical option call price using the Black-Scholes option pricing formula. A

²⁹ HKSA 330, paragraph 28(b)

Responses to the Assessed Risks of Material Misstatement

The Auditor's Further Audit Procedures (Ref: Para. 18)

A81. In designing and performing further audit procedures the auditor may use any of the three testing approaches (individually or in combination) listed in paragraph 18. For example, when several assumptions are used to make an accounting estimate, the auditor may decide to use a different testing approach for each assumption tested.

Obtaining Relevant Audit Evidence Whether Corroborative or Contradictory

A82. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions.⁴⁴ Obtaining audit evidence in an unbiased manner may involve obtaining evidence from multiple sources within and outside the entity. However, the auditor is not required to perform an exhaustive search to identify all possible sources of audit evidence.

A83. HKSA 330 requires the auditor to obtain more persuasive audit evidence the higher the auditor's assessment of the risk.⁴⁵ Therefore, the consideration of the nature or quantity of the audit evidence may be more important when inherent risks relating to an accounting estimate is assessed at the higher end of the spectrum of inherent risk.

Scalability

A84. The nature, timing and extent of the auditor's further audit procedures are affected by, for example:

- The assessed risks of material misstatement, which affect the persuasiveness of the audit evidence needed and influence the approach the auditor selects to audit an accounting estimate. For example, the assessed risks of material misstatement relating to the existence or valuation assertions may be lower for a straightforward accrual for bonuses that are paid to employees shortly after period end. In this situation, it may be more practical for the auditor to obtain sufficient appropriate audit evidence by evaluating events occurring up to the date of the auditor's report, rather than through other testing approaches.
- The reasons for the assessed risks of material misstatement.

When the Auditor Intends to Rely on the Operating Effectiveness of Relevant Controls (Ref: Para: 19)

A85. Testing the operating effectiveness of relevant controls may be appropriate when inherent risk is assessed as higher on the spectrum of inherent risk, including for significant risks. This may be the case when the accounting estimate is subject to or affected by a high degree of complexity. When the accounting estimate is affected by a high degree of subjectivity, and therefore requires significant judgment by management, inherent limitations in the effectiveness of the design of controls may lead the auditor to focus more on substantive procedures than on testing the operating effectiveness of controls.

A86. In determining the nature, timing and extent of testing of the operating effectiveness of controls relating to accounting estimates, the auditor may consider factors such as:

- The nature, frequency and volume of transactions;
- The effectiveness of the design of the controls, including whether controls are appropriately designed to respond to the assessed inherent risk, and the strength of governance;
- The importance of particular controls to the overall control objectives and processes in place at the entity, including the sophistication of the information system to support transactions;
- The monitoring of controls and identified deficiencies in internal control;

⁴⁴ HKSA 500, paragraph A5

⁴⁵ HKSA 330, paragraphs 7(b) and A19

- A124. The requirement in paragraph 29(a) for the auditor to determine that the range includes only amounts that are supported by sufficient appropriate audit evidence does not mean that the auditor is expected to obtain audit evidence to support each possible outcome in the range individually. Rather, the auditor is likely to obtain evidence to determine that the points at both ends of the range are reasonable in the circumstances, thereby supporting that amounts falling between those two points also are reasonable.
- A125. The size of the auditor's range may be multiples of materiality for the financial statements as a whole, particularly when materiality is based on operating results (for example, pre-tax income) and this measure is relatively small in relation to assets or other balance sheet measures. This situation is more likely to arise in circumstances when the estimation uncertainty associated with the accounting estimate is itself multiples of materiality, which is more common for certain types of accounting estimates or in certain industries, such as insurance or banking, where a high degree of estimation uncertainty is more typical and there may be specific requirements in the applicable financial reporting framework in that regard. Based on the procedures performed and audit evidence obtained in accordance with the requirements of this HKSA, the auditor may conclude that a range that is multiples of materiality is, in the auditor's judgment, appropriate in the circumstances. When this is the case, the auditor's evaluation of the reasonableness of the disclosures about estimation uncertainty becomes increasingly important, particularly whether such disclosures appropriately convey the high degree of estimation uncertainty and the range of possible outcomes. Paragraphs A139–A144 include additional considerations that may be relevant in these circumstances.

Other Considerations Relating to Audit Evidence (Ref: Para. 30)

- A126. Information to be used as audit evidence, regarding risks of material misstatement relating to accounting estimates, may have been produced by the entity, prepared using the work of a management's expert, or provided by an external information source.

External Information Sources

- A127. As explained in HKSA 500,⁵³ the reliability of information from an external information source is influenced by its source, its nature, and the circumstances under which it is obtained. Consequently, the nature and extent of the auditor's further audit procedures to consider the reliability of the information used in making an accounting estimate may vary depending on the nature of these factors. For example:
- When market or industry data, prices, or pricing related data, are obtained from a single external information source, specializing in such information, the auditor may seek a price from an alternative independent source with which to compare.
 - When market or industry data, prices, or pricing related data, are obtained from multiple independent external information sources and points to consensus across those sources, the auditor may need to obtain less evidence about the reliability of the data from an individual source.
 - When information obtained from multiple information sources points to divergent market views the auditor may seek to understand the reasons for the diversity in views. The diversity may result from the use of different methods, assumptions, or data. For example, one source may be using current prices and another source using future prices. When the diversity relates to estimation uncertainty, the auditor is required by paragraph 26(b) to obtain sufficient appropriate audit evidence about whether, in the context of the applicable financial reporting framework, the disclosures in the financial statements that describe the estimation uncertainty are reasonable. In such cases professional judgment is also important in considering information about the methods, assumptions or data applied.
 - When information obtained from an external information source has been developed by that source using its own model(s). Paragraph A43 of HKSA 500 provides relevant guidance.

⁵³ HKSA 500, Paragraph A35

- A128. For fair value accounting estimates, additional considerations of the relevance and reliability of information obtained from external information sources may include:
- (a) Whether fair values are based on trades of the same instrument or active market quotations;
 - (b) When the fair values are based on transactions of comparable assets or liabilities, how those transactions are identified and considered comparable;
 - (c) When there are no transactions either for the asset or liability or comparable assets or liabilities, how the information was developed including whether the inputs developed and used represent the assumptions that market participants would use when pricing the asset or liability, if applicable; and
 - (d) When the fair value measurement is based on a broker quote, whether the broker quote:
 - (i) Is from a market maker who transacts in the same type of financial instrument;
 - (ii) Is binding or nonbinding, with more weight placed on quotes based on binding offers; and
 - (iii) Reflects market conditions as of the date of the financial statements, when required by the applicable financial reporting framework.
- A129. When information from an external information source is used as audit evidence, a relevant consideration for the auditor may be whether information can be obtained, or whether the information is sufficiently detailed, to understand the methods, assumptions and other data used by the external information source. This may be limited in some respects and consequently influence the auditor's consideration of the nature, timing and extent of procedures to perform. For example, pricing services often provide information about their methods and assumptions by asset class rather than individual securities. Brokers often provide only limited information about their inputs and assumptions when providing broker indicative quotes for individual securities. Paragraph A44 of HKSA 500 provides guidance with respect to restrictions placed by the external information source on the provision of supporting information.

Management's Expert

- A130. Assumptions relating to accounting estimates that are made or identified by a management's expert become management's assumptions when used by management in making an accounting estimate. Accordingly, the auditor applies the relevant requirements in this HKSA to those assumptions.
- A131. If the work of a management's expert involves the use of methods or sources of data relating to accounting estimates, or developing or providing findings or conclusions relating to a point estimate or related disclosures for inclusion in the financial statements, the requirements in paragraphs 21–29 of this HKSA may assist the auditor in applying paragraph 8(c) of HKSA 500.

Service Organizations

- A132. HKSA 402⁵⁴ deals with the auditor's understanding of the services provided by a service organization, including internal control, as well as the auditor's responses to assessed risks of material misstatement. When the entity uses the services of a service organization in making accounting estimates, the requirements and guidance in HKSA 402 may therefore assist the auditor in applying the requirements of this HKSA.

⁵⁴ HKSA 402, *Audit Considerations Relating to an Entity Using a Service Organization*

HKSA 580
Issued July 2009; revised July 2010, June 2014, August 2015,
January 2016, August 2016, June 2017, January 2021

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

Hong Kong Standard on Auditing 580

Written Representations



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- (c) Take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with HKSA 705 (Revised), having regard to the requirement in paragraph 20 of this HKSA.

Written Representations about Management's Responsibilities

- 20. The auditor shall disclaim an opinion on the financial statements in accordance with HKSA 705 (Revised) if:
 - (a) The auditor concludes that there is sufficient doubt about the integrity of management such that the written representations required by paragraphs 10 and 11 are not reliable; or
 - (b) Management does not provide the written representations required by paragraphs 10 and 11. (Ref: Para. A26-A27)

Conformity and Compliance with International Standards on Auditing

- 21. As of January 2021, this HKSA conforms with International Standard on Auditing (ISA) 580, *Written Representations*. Compliance with the requirements of this HKSA ensures compliance with ISA 580.
- 22. Additional local explanation is provided in footnote 1a and additional local guidance is provided in footnote 2a and 3a of Appendix 2.

Application and Other Explanatory Material

Written Representations as Audit Evidence (Ref: Para. 3)

- A1. Written representations are an important source of audit evidence. If management modifies or does not provide the requested written representations, it may alert the auditor 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.

Management from whom Written Representations Requested (Ref: Para. 9)

- A2. Written representations are requested from those responsible for the preparation of the financial statements. Those individuals may vary depending on the governance structure of the entity, and relevant law or regulation; however, management (rather than those charged with governance) is often the responsible party. Written representations may therefore be requested from the entity's chief executive officer and chief financial officer, or other equivalent persons in entities that do not use such titles. In some circumstances, however, other parties, such as those charged with governance, are also responsible for the preparation of the financial statements.
- A3. Due to its responsibility for the preparation of the financial statements, and its responsibilities for the conduct of the entity's business, management would be expected to have sufficient knowledge of the process followed by the entity in preparing the financial statements and the assertions therein on which to base the written representations.
- A4. In some cases, however, management may decide to make inquiries of others who participate in preparing and presenting the financial statements and assertions therein, including individuals who have specialized knowledge relating to the matters about which written representations are requested. Such individuals may include:

Appendix 1

(Ref: Para. 2)

List of HKSAs Containing Requirements for Written Representations

This appendix identifies paragraphs in other HKSAs that require subject-matter specific written representations. The list is not a substitute for considering the requirements and related application and other explanatory material in HKSAs.

- HKSA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements* – paragraph 39
- HKSA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements* – paragraph 16
- HKSA 450, *Evaluation of Misstatements Identified during the Audit* – paragraph 14
- HKSA 501, *Audit Evidence—Specific Considerations for Selected Items* – paragraph 12
- HKSA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures* – paragraph 37
- HKSA 550, *Related Parties* – paragraph 26
- HKSA 560, *Subsequent Events* – paragraph 9
- HKSA 570 (Revised), *Going Concern* – paragraph 16(e)
- HKSA 710, *Comparative Information—Corresponding Figures and Comparative Financial Statements* – paragraph 9
- HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information* – paragraph 13(c)

WRITTEN REPRESENTATIONS

- The methods, the data, and the significant assumptions used by us in making accounting estimates and their related disclosures are appropriate to achieve recognition, measurement or disclosure that is reasonable in the context of the applicable financial reporting framework. (HKSA 540(Revised))
- Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of Hong Kong Financial Reporting Standards. (HKSA 550)
- All events subsequent to the date of the financial statements and for which Hong Kong Financial Reporting Standards require adjustment or disclosure have been adjusted or disclosed. (HKSA 560)
- The effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements as a whole. A list of the uncorrected misstatements is attached to the representation letter. (HKSA 450)
- [Any other matters that the auditor may consider appropriate (see paragraph A10 of this HKSA).]

Information Provided

- We have provided you with: ³
 - Access to all information of which we are aware that is relevant to the preparation of the financial statements, such as records, documentation and other matters;
 - Additional information that you have requested from us for the purpose of the audit; and
 - Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.
- All transactions have been recorded in the accounting records and are reflected in the financial statements.
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud. (HKSA 240)
- We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the entity and involves:
 - Management;
 - Employees who have significant roles in internal control; or
 - Others where the fraud could have a material effect on the financial statements. (HKSA 240)
- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others. (HKSA 240)

³ If the auditor has included other matters relating to management's responsibilities in the audit engagement letter in accordance with HKSA 210, *Agreeing the Terms of Audit Engagements*, consideration may be given to including these matters in the written representations from management or those charged with governance.

WRITTEN REPRESENTATIONS

- We have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements. (HKSA 250)
- We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware. (HKSA 550)
- [Any other matters that the auditor may consider necessary (see paragraph A11 of this HKSA).]^{3a}

Management

Management

^{3a} If the auditor has included management's responsibilities for other information in the audit engagement letter in accordance with HKSA 210, consideration may be given to include these in the written representations from management or those charged with governance:

Other Information

- In addition to the (consolidated)* financial statements, we are responsible for the preparation of other information included in the annual report. We have informed you of all the documents that we expect to issue that may comprise other information.
- We confirm that the other information comprises [X documents - input specific description of the other information]] which we provided to you prior to or as of [input the date of your auditor's report], [and the [Y documents - input specific description of the other information not obtained as of auditor's report date] which is/are expected to be made available to you by [input the expected timing of issuance].]
- We confirm that the (consolidated)* financial statements and any other information provided to you are consistent with one another, and the other information does not contain any material misstatements.

HKSA 620
Issued July 2009; revised July 2010, July 2020, January 2021

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

Hong Kong Standard on Auditing 620

Using the Work of an Auditor's Expert



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Introduction

Scope of this HKSA

1. This Hong Kong Standard on Auditing (HKSA) deals with the auditor's responsibilities relating to the work of an individual or organization in a field of expertise other than accounting or auditing, when that work is used to assist the auditor in obtaining sufficient appropriate audit evidence.
2. This HKSA does not deal with:
 - (a) Situations where the engagement team includes a member, or consults an individual or organization, with expertise in a specialized area of accounting or auditing, which are dealt with in HKSA 220;¹ or
 - (b) The auditor's use of the work of 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 (a management's expert), which is dealt with in HKSA 500.²

The Auditor's Responsibility for the Audit Opinion

3. The auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the auditor's use of the work of an auditor's expert. Nonetheless, if the auditor using the work of an auditor's expert, having followed this HKSA, concludes that the work of that expert is adequate for the auditor's purposes, the auditor may accept that expert's findings or conclusions in the expert's field as appropriate audit evidence.

Effective Date

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

Objectives

5. The objectives of the auditor are:
 - (a) To determine whether to use the work of an auditor's expert; and
 - (b) If using the work of an auditor's expert, to determine whether that work is adequate for the auditor's purposes.

Definitions

6. For purposes of the HKSAs, the following terms have the meanings attributed below:
 - (a) Auditor'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 auditor to assist the auditor in obtaining sufficient appropriate audit evidence. An auditor's expert may be either an

¹ HKSA 220, "Quality Control for an Audit of Financial Statements," paragraphs A10, A20-A22.

² HKSA 500, "Audit Evidence," paragraphs A45-A59.

Conformity and Compliance with International Standards on Auditing

16. As of January 2021, this HKSA conforms with International Standard on Auditing (ISA) 620 "Using the Work of an Auditor's Expert". Compliance with the requirements of this HKSA ensures compliance with ISA 620.

Application and Other Explanatory Material

Definition of an Auditor's Expert (Ref: Para. 6(a))

- A1. Expertise in a field other than accounting or auditing may include expertise in relation to such matters as:
- The valuation of complex financial instruments, land and buildings, plant and machinery, jewelry, works of art, antiques, intangible assets, assets acquired and liabilities assumed in business combinations and assets that may have been impaired.
 - The actuarial calculation of liabilities associated with insurance contracts or employee benefit plans.
 - The estimation of oil and gas reserves.
 - The valuation of environmental liabilities, and site clean-up costs.
 - The interpretation of contracts, laws and regulations.
 - The analysis of complex or unusual tax compliance issues.
- A2. In many cases, distinguishing between expertise in accounting or auditing, and expertise in another field, will be straightforward, even where this involves a specialized area of accounting or auditing. For example, an individual with expertise in applying methods of accounting for deferred income tax can often be easily distinguished from an expert in taxation law. The former is not an expert for the purposes of this HKSA as this constitutes accounting expertise; the latter is an expert for the purposes of this HKSA as this constitutes legal expertise. Similar distinctions may also be able to be made in other areas, for example, between expertise in methods of accounting for financial instruments, and expertise in complex modeling for the purpose of valuing financial instruments. In some cases, however, particularly those involving an emerging area of accounting or auditing expertise, distinguishing between specialized areas of accounting or auditing, and expertise in another field, will be a matter of professional judgment. Applicable professional rules and standards regarding education and competency requirements for accountants and auditors may assist the auditor in exercising that judgment.⁴
- A3. It is necessary to apply judgment when considering how the requirements of this HKSA are affected by the fact that an auditor's expert may be either an individual or an organization. For example, when evaluating the competence, capabilities and objectivity of an auditor's expert, it may be that the expert is an organization the auditor has previously used, but the auditor has no prior experience of the individual expert assigned by the organization for the particular engagement; or it may be the reverse, that is, the auditor may be familiar with the work of an individual expert but not with the organization that expert has joined. In either case, both the

⁴ For example, International Education Standard 8, "Competence Requirements for Audit Professionals" may be of assistance.

HKSA 700 (Revised)
Issued August 2015; revised January 2016, August 2016,
June 2017, September 2019, July 2020, January 2021

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

Hong Kong Standard on Auditing 700 (Revised)

Forming an Opinion and Reporting on Financial Statements



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Requirements

Forming an Opinion on the Financial Statements

10. The auditor shall form an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.^{9,10}
11. In order to form that opinion, the auditor shall conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. That conclusion shall take into account:
 - (a) The auditor's conclusion, in accordance with HKSA 330, whether sufficient appropriate audit evidence has been obtained;¹¹
 - (b) The auditor's conclusion, in accordance with HKSA 450, whether uncorrected misstatements are material, individually or in aggregate;¹² and
 - (c) The evaluations required by paragraphs 12–15.
12. The auditor shall evaluate whether the financial statements are prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework. This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments. (Ref: Para. A1–A3)
13. In particular, the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework:
 - (a) The financial statements appropriately disclose the significant accounting policies selected and applied. In making this evaluation, the auditor shall consider the relevance of the accounting policies to the entity, and whether they have been presented in an understandable manner; (Ref: Para. A4)
 - (b) The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;
 - (c) The accounting estimates and related disclosures made by management are reasonable;
 - (d) The information presented in the financial statements is relevant, reliable, comparable, and understandable. In making this evaluation, the auditor shall consider whether
 - The information that should have been included has been included, and whether such information is appropriately classified, aggregated or disaggregated, and characterized.
 - The overall presentation of the financial statements has been undermined by including information that is not relevant or that obscures a proper understanding of the matters disclosed. (Ref: Para. A5)
 - (e) The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements; and (Ref: Para. A6)

⁹ HKSA 200, paragraph 11

¹⁰ Paragraphs 25–26 deal with the phrases used to express this opinion in the case of a fair presentation framework and a compliance framework respectively.

¹¹ HKSA 330, *The Auditor's Responses to Assessed Risks*, paragraph 26

¹² HKSA 450, *Evaluation of Misstatements Identified during the Audit*, paragraph 11

52. When the auditor's report refers to both the other auditing standards and Hong Kong Standards on Auditing, the auditor's report shall identify the jurisdiction of origin of the other auditing standards.

Supplementary Information Presented with the Financial Statements (Ref: Para. A78–A84)

53. If supplementary information that is not required by the applicable financial reporting framework is presented with the audited financial statements, the auditor shall evaluate whether, in the auditor's professional judgment, supplementary information is nevertheless an integral part of the financial statements due to its nature or how it is presented. When it is an integral part of the financial statements, the supplementary information shall be covered by the auditor's opinion.
54. If supplementary information that is not required by the applicable financial reporting framework is not considered an integral part of the audited financial statements, the auditor shall evaluate whether such supplementary information is presented in a way that sufficiently and clearly differentiates it from the audited financial statements. If this is not the case, then the auditor shall ask management to change how the unaudited supplementary information is presented. If management refuses to do so, the auditor shall identify the unaudited supplementary information and explain in the auditor's report that such supplementary information has not been audited.

Conformity and Compliance with International Standards on Auditing

55. As of January 2021, this HKSA conforms with International Standard on Auditing (ISA) 700 (Revised), *Forming an Opinion and Reporting on Financial Statements* except that references to IESBA's 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 HKSA ensures compliance with ISA 700 (Revised).
56. Additional local explanations are provided in footnotes 12a, 14a, 17a, 17b, 25a, 25b, 35a, 36a and 37a.
57. Additional local guidance is provided in the Appendix.

Application and Other Explanatory Material

Qualitative Aspects of the Entity's Accounting Practices (Ref: Para. 12)

- A1. Management makes a number of judgments about the amounts and disclosures in the financial statements.
- A2. HKSA 260 (Revised) contains a discussion of the qualitative aspects of accounting practices.¹⁹ In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgments. The auditor may conclude that the cumulative effect of a lack of neutrality, together with the effect of uncorrected misstatements, causes the financial statements as a whole to be materially misstated. Indicators of a lack of neutrality that may affect the auditor's evaluation of whether the financial statements as a whole are materially misstated include the following:
- The selective correction of misstatements brought to management's attention during the audit (e.g., correcting misstatements with the effect of increasing reported earnings, but not correcting misstatements that have the effect of decreasing reported earnings).

¹⁹ HKSA 260 (Revised), *Communication with Those Charged with Governance*, Appendix 2

In our opinion, the financial statements give a true and fair view of the financial position of the Company as at 31 December 20X1, and of its financial performance and its cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA")³⁹ [and have been properly prepared in compliance with the disclosure requirements of the Hong Kong Companies Ordinance]⁴⁰.

Basis for Opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSA") issued by the HKICPA. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the HKICPA's *Code of Ethics for Professional Accountants* ("the Code") together with the ethical requirements that are relevant to our audit of the financial statements in [jurisdiction], and we have fulfilled our other ethical responsibilities in accordance with these requirements and the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

[Description of each key audit matter in accordance with HKSA 701.]

Other Information [or another title if appropriate such as "Information Other than the Financial Statements and Auditor's Report Thereon"]

[Reporting in accordance with the reporting requirements in HKSA 720 (Revised) – see Illustration 1 in Appendix 2 of HKSA 720 (Revised).]

Responsibilities of Directors and Those Charged with Governance for the Financial Statements⁴¹

The directors are responsible for the preparation of the financial statements that give a true and fair view in accordance with HKFRSs issued by the HKICPA [and the disclosure requirements of the Hong Kong Companies Ordinance]⁴⁵ and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

³⁹ It may be necessary to refer to International Financial Reporting Standards or other national accounting standards and / or other national legal requirements depending on the jurisdiction in which the company is incorporated.

⁴⁰ For a company incorporated overseas and listed in Hong Kong, the disclosure requirements of the Hong Kong Companies Ordinance are applicable.

⁴¹ Or other that are appropriate in the context of the legal framework in the particular jurisdiction.

HKSA 701
Issued August 2015; revised June 2017, January 2021

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

Hong Kong Standard on Auditing 701

Communicating Key Audit Matters in the Independent Auditor's Report



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Objectives

7. The objectives of the auditor are to determine key audit matters and, having formed an opinion on the financial statements, communicate those matters by describing them in the auditor's report.

Definition

8. For purposes of the HKSAs, the following term has the meaning attributed below:

Key audit matters—Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.

Requirements

Determining Key Audit Matters

9. The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following: (Ref: Para. A9–A18)
 - (a) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with HKSA 315 (Revised).⁵ (Ref: Para. A19–A22)
 - (b) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that are subject to a high degree of estimation uncertainty. (Ref: Para. A23–A24)
 - (c) The effect on the audit of significant events or transactions that occurred during the period. (Ref: Para. A25–A26)
10. The auditor shall determine which of the matters determined in accordance with paragraph 9 were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters. (Ref: Para. A9–A11, A27–A30)

Communicating Key Audit Matters

11. The auditor shall describe each key audit matter, using an appropriate subheading, in a separate section of the auditor's report under the heading "Key Audit Matters," unless the circumstances in paragraphs 14 or 15 apply. The introductory language in this section of the auditor's report shall state that:
 - (a) Key audit matters are those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements [of the current period]; and
 - (b) These matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, and the auditor does not provide a separate opinion on these matters. (Ref: Para. A31–A33)

⁵ HKSA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

Communication with Those Charged with Governance

17. The auditor shall communicate with those charged with governance:
- (a) Those matters the auditor has determined to be the key audit matters; or
 - (b) If applicable, depending on the facts and circumstances of the entity and the audit, the auditor's determination that there are no key audit matters to communicate in the auditor's report. (Ref: Para. A60–A63)

Documentation

18. The auditor shall include in the audit documentation:⁶ (Ref: Para. A64)
- (a) The matters that required significant auditor attention as determined in accordance with paragraph 9, and the rationale for the auditor's determination as to whether or not each of these matters is a key audit matter in accordance with paragraph 10;
 - (b) Where applicable, the rationale for the auditor's determination that there are no key audit matters to communicate in the auditor's report or that the only key audit matters to communicate are those matters addressed by paragraph 15; and
 - (c) Where applicable, the rationale for the auditor's determination not to communicate in the auditor's report a matter determined to be a key audit matter.

Conformity and Compliance with International Standards on Auditing

19. As of January 2021, this HKSA conforms with International Standard on Auditing (ISA) 701, *Communicating Key Audit Matters in the Independent Auditor's Report*. Compliance with the requirements of this HKSA ensures compliance with ISA 701.

Application and Other Explanatory Material**Scope of this HKSA** (Ref: Para. 2)

- A1. Significance can be described as the relative importance of a matter, taken in context. The significance of a matter is judged by the auditor in the context in which it is being considered. Significance can be considered in the context of quantitative and qualitative factors, such as relative magnitude, the nature and effect on the subject matter and the expressed interests of intended users or recipients. This involves an objective analysis of the facts and circumstances, including the nature and extent of communication with those charged with governance.
- A2. Users of financial statements have expressed an interest in those matters about which the auditor had the most robust dialogue with those charged with governance as part of the two-way communication required by HKSA 260 (Revised)⁷ and have called for additional transparency about those communications. For example, users have expressed particular interest in understanding significant judgments made by the auditor in forming the opinion on the financial statements as a whole, because they are often related to the areas of significant management judgment in preparing the financial statements.
- A3. Requiring auditors to communicate key audit matters in the auditor's report may also enhance communications between the auditor and those charged with governance about those matters,

⁶ HKSA 230, *Audit Documentation*, paragraphs 8–11 and A6

⁷ HKSA 260 (Revised), *Communication with Those Charged with Governance*

- A21. However, this may not be the case for all significant risks. For example, HKSA 240 presumes that there are risks of fraud in revenue recognition and requires the auditor to treat those assessed risks of material misstatement due to fraud as significant risks.²⁴ In addition, HKSA 240 indicates that, due to the unpredictable way in which management override of controls could occur, it is a risk of material misstatement due to fraud and thus a significant risk.²⁵ Depending on their nature, these risks may not require significant auditor attention, and therefore would not be considered in the auditor's determination of key audit matters in accordance with paragraph 10.
- A22. HKSA 315 (Revised) explains that the auditor's assessment of the risks of material misstatement at the assertion level may change during the course of the audit as additional audit evidence is obtained.²⁶ Revision to the auditor's risk assessment and reevaluation of the planned audit procedures with respect to a particular area of the financial statements (i.e., a significant change in the audit approach, for example, if the auditor's risk assessment was based on an expectation that certain controls were operating effectively and the auditor has obtained audit evidence that they were not operating effectively throughout the audit period, particularly in an area with higher assessed risk of material misstatement) may result in an area being determined as one requiring significant auditor attention.

Significant Auditor Judgments Relating to Areas in the Financial Statements that Involved Significant Management Judgment, Including Accounting Estimates that Are Subject to a High Degree of Estimation Uncertainty (Ref: Para. 9(b))

- A23. HKSA 260 (Revised) requires the auditor to communicate with those charged with governance the auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures.²⁷ In many cases, this relates to critical accounting estimates and related disclosures, which are likely to be areas of significant auditor attention, and also may be identified as significant risks.
- A24. However, users of the financial statements have highlighted their interest in accounting estimates that are subject to a high degree of estimation uncertainty (see HKSA 540 (Revised)²⁸) that may have not been determined to be significant risks. Among other things, such estimates are highly dependent on management judgment and are often the most complex areas of the financial statements, and may require the involvement of both a management's expert and an auditor's expert. Users have also highlighted that accounting policies that have a significant effect on the financial statements (and significant changes to those policies) are relevant to their understanding of the financial statements, especially in circumstances where an entity's practices are not consistent with others in its industry.

The Effect on the Audit of Significant Events or Transactions that Occurred during the Period (Ref: Para. 9(c))

- A25. Events or transactions that had a significant effect on the financial statements or the audit may be areas of significant auditor attention and may be identified as significant risks. For example, the auditor may have had extensive discussions with management and those charged with

²⁴ HKSA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, paragraphs 26–27

²⁵ HKSA 240, paragraph 31

²⁶ HKSA 315 (Revised), paragraph 31

²⁷ HKSA 260 (Revised), paragraph 16(a)

²⁸ See paragraphs 16–17 of HKSA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*.

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Practice Note 860.1 (Revised)

The Audit of Retirement Schemes



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31. In the event that a qualified actuarial certificate is issued, the auditor is advised to refer to Part 2 of Schedule 2 to the ORSO (which details information to be given by the actuary).
32. In addition to the statutory requirements set out above, actuarial reports can provide an assessment of a defined benefit scheme's progress in achieving its objective of providing members' future benefits. The results of an actuarial review are used to determine the appropriate contribution level and to indicate any surplus or deficiency in the funding of the retirement scheme.
33. A practical way of showing the level of funding of a scheme is for the actuary to indicate the trend in the values of the following from the latest valuation and from previous valuations, if they are available:
 - a. the amount of aggregate vested liabilities; and
 - b. the amount of aggregate past service liabilities.
34. The actuary arrives at the actuarial valuation by taking the discounted value of future benefits that are expected to arise in the scheme in respect of members, and comparing this with the value of scheme assets, and the discounted value of future contributions. The actuary would also compare scheme assets with past service liabilities and vested liabilities. In doing so the actuary makes a number of assumptions, including earnings rate, inflation, salary increases and staff turnover rates.

The auditor's responsibilities

35. In considering the work of the actuary as audit evidence, the auditor considers the requirements of HKSA 500 *Audit Evidence* on information produced by a management expert.
36. As set out in paragraph 8 of HKSA 500, if information to be used as audit evidence has been prepared using the work of a management's expert, the auditor is required to perform the following procedures:
 - 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 audit evidence for the relevant assertion.

Further guidance is set out in paragraphs A48 to A59 of HKSA 500. Additional specific considerations which apply in the audit of retirement schemes are set out below in paragraphs 37 to 41 below.

37. In evaluating the work of an actuary, the auditor is required to consider the following:
 - a. the source data used;
 - b. the assumptions and methods used and their consistency; and
 - c. the results of the expert's work in the context of the auditor's overall knowledge.
38. The auditor would need to be satisfied as to the accuracy and reasonableness of the source data. The source data used is provided by the administrator and includes information on salaries, date of birth of members, date of joining the employer, date of joining the scheme, contribution rates, accumulation of member and employer contributions, transfer of benefits (if any), benefit multiples and investments held.