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

MEMBERS' HANDBOOK

Update No. 172

(Issued 31 August 2015)

Document Reference and Title	*Instructions*	*Explanations*
VOLUME III		
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HONG KONG STANDARDS ON AUDITING		
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HKSA 220 *Quality Control for an Audit of Financial Statements*	Insert after HKSA 220 (Clarified) revised in February 2015.	Note 2
HKSA 230 *Audit Documentation*	Insert after HKSA 230 (Clarified) revised in February 2015.	Notes 2, 3
HKSA 260 (Revised) *Communication with Those Charged with Governance*	Insert after HKSA 260 (Clarified) revised in February 2015.	Notes 1, 3
HKSA 450 *Evaluation of Misstatements Identified during the Audit*	Insert after HKSA 450 (Clarified) revised in July 2010.	Note 3
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HKSA 570 (Revised) *Going Concern*	Insert after HKSA 570 (Clarified) revised in July 2010.	Notes 1, 3
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HKSA 705 (Revised) *Modifications to the Opinion in the Independent Auditor's Report*	Insert after HKSA 705 (Clarified) revised in June 2014.	Notes 1, 3
HKSA 706 (Revised) *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*	Insert after HKSA 706 (Clarified) revised in June 2014.	Notes 1, 3
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HKSA 720 (Revised) *The Auditor's Responsibilities Relating to Other Information*	Insert after HKSA 720 (Clarified) revised in June 2014.	Note 3
HKSA 810 *Engagements to Report on Summary Financial Statements*	Insert after HKSA 810 (Clarified) revised in September 2014.	Note 3

Note:

1. New and revised Hong Kong Standards on Auditing (HKSAs) are issued in response to the International Auditing and Assurance Board's (IAASB) project on auditor reporting to enhance auditor's reports for investors and other users of financial statements. The new and revised auditor reporting standards are:

    - HKSA 260 (Revised), *Communication with Those Charged with Governance*
    - HKSA 570 (Revised), *Going Concern*
    - HKSA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*
    - New HKSA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*
    - HKSA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*
    - HKSA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*

The HKSAs conform with the IAASB's new and revised auditor reporting standards. The standards will be effective for audits of financial statements for periods ending on or after 15 December 2016.

2. Accompanying the release of the new and revised auditor reporting standards are conforming amendments to the following HKSAs:

- HKSA 210, *Agreeing the Terms of Audit Engagements*
- HKSA 220, *Quality Control for an Audit of Financial Statements*
- HKSA 230, *Audit Documentation*
- HKSA 510, *Initial Audit Engagements—Opening Balances*
- HKSA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*
- HKSA 580, *Written Representations*
- HKSA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*
- HKSA 710, *Comparative Information—Corresponding Figures and Comparative Financial Statements*

The conforming amendments to the above HKSAs are marked up in the respective standards and they will be effective for audits of financial statements for periods ending on or after 15 December 2016.

3. The revisions in HKSA 720 (Revised) aim to clarify and increase the auditor's involvement with "other information" - defined in the standard as financial and non-financial information, other than the audited financial statements, that is included in entities' annual reports. The standard also includes new requirements related to auditor reporting on other information that complement the changes arising from the Hong Kong new and revised Auditor Reporting standards as set out in 1. above. Concurrent with those standards, HKSA 720 (Revised) will be effective for audits of financial statements for periods ending on or after 15 December 2016.

Accompanying the release of HKSA 720 (Revised) are conforming amendments to the following HKSAs:

- HKSA 210, *Agreeing the Terms of Audit Engagements*
- HKSA 230, *Audit Documentation*
- HKSA 260, (Revised) *Communication with Those Charged with Governance*
- HKSA 450, *Evaluation of Misstatements Identified during the Audit*
- HKSA 500, *Audit Evidence*
- HKSA 510, *Initial Audit Engagements—Opening Balances*
- HKSA 560, *Subsequent Events*
- HKSA 570, (Revised) *Going Concern*
- HKSA 580, *Written Representations*
- HKSA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*
- HKSA 700, (Revised), *Forming an Opinion and Reporting on Financial Statements*
- HKSA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*
- HKSA 705, (Revised), *Modifications to the Opinion in the Independent Auditor's Report*
- HKSA 706, (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*
- HKSA 710, *Comparative Information—Corresponding Figures and Comparative Financial Statements*
- HKSA 810, *Engagements to Report on Summary Financial Statements*

The conforming amendments will be effective for audits of financial statements for periods ending on or after 15 December 2016. The conforming amendments to HKSAs 260 (Revised), 570 (Revised), 700 (Revised), 701, 705 (Revised) and 706 (Revised) are incorporated in the new and revised HKSAs. The conforming amendments to other HKSAs are marked up in the respective standards.

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MEMBERS' HANDBOOK
CONTENTS OF VOLUME III

(Updated to August 2015)

AUDITING GUIDELINES

HONG KONG AUDITING PRACTICE GUIDANCE

HKSA 210

Issued June 2009; revised July, October 2010, December 2012,

June 2014*, August 2015**

Effective for audits of financial statements

for periods beginning on or after 15 December 2009

Hong Kong Standard on Auditing 210

Agreeing the Terms of Audit Engagements

** Conforming amendments have been made to this HKSA as a result of the new and revised HKSAs issued in Update 172, and will become effective for audits of financial statements for periods ending on or after 15 December 2016. The conforming amendments are underlined for easy reference.

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

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HONG KONG STANDARD ON AUDITING 210

AGREEING THE TERMS OF AUDIT ENGAGEMENTS

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

CONTENTS

Hong Kong Standard on Auditing (HKSA) 210, "Agreeing the Terms of Audit Engagements" should be read in conjunction with HKSA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing."

Introduction

Scope of this HKSA

1. This Hong Kong Standard on Auditing (HKSA) deals with the auditor's responsibilities in agreeing the terms of the audit engagement with management and, where appropriate, those charged with governance. This includes establishing that certain preconditions for an audit, responsibility for which rests with management and, where appropriate, those charged with governance, are present. HKSA 220[1] deals with those aspects of engagement acceptance that are within the control of the auditor. (Ref: Para. A1)

Effective Date

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

Objective

3. The objective of the auditor is to accept or continue an audit engagement only when the basis upon which it is to be performed has been agreed, through:

   (a) Establishing whether the preconditions for an audit are present; and

   (b) Confirming that there is a common understanding between the auditor and management and, where appropriate, those charged with governance of the terms of the audit engagement.

Definitions

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

   Preconditions for an audit – The use by management of an acceptable financial reporting framework in the preparation of the financial statements and the agreement of management and, where appropriate, those charged with governance to the premise[2] on which an audit is conducted.

5. For the purposes of this HKSA, references to "management" should be read hereafter as "management and, where appropriate, those charged with governance."

Requirements

Preconditions for an Audit

6. In order to establish whether the preconditions for an audit are present, the auditor shall:

   (a) Determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable; and (Ref: Para. A2-A10)

   (b) Obtain the agreement of management that it acknowledges and understands its responsibility: (Ref: Para. A11-A14, A20)

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[1] HKSA 220, "Quality Control for an Audit of Financial Statements."

[2] HKSA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing," paragraph 13.

(i) For the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation; (Ref: Para. A15)

(ii) For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and (Ref: Para. A16-A19)

(iii) To provide the auditor with:

a. Access to all information of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;

b. Additional information that the auditor may request from management for the purpose of the audit; and

c. Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

Limitation on Scope Prior to Audit Engagement Acceptance

7. If management or those charged with governance impose a limitation on the scope of the auditor's work in the terms of a proposed audit engagement such that the auditor believes the limitation will result in the auditor disclaiming an opinion on the financial statements, the auditor shall not accept such a limited engagement as an audit engagement, unless required by law or regulation to do so.

Other Factors Affecting Audit Engagement Acceptance

8. If the preconditions for an audit are not present, the auditor shall discuss the matter with management. Unless required by law or regulation to do so, the auditor shall not accept the proposed audit engagement:

(a) If the auditor has determined that the financial reporting framework to be applied in the preparation of the financial statements is unacceptable, except as provided in paragraph 19; or

(b) If the agreement referred to in paragraph 6(b) has not been obtained.

Agreement on Audit Engagement Terms

9. The auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate. (Ref: Para. A21)

10. Subject to paragraph 11, the agreed terms of the audit engagement shall be recorded in an audit engagement letter[2a] or other suitable form of written agreement and shall include: (Ref: Para. A22-A25)

(a) The objective and scope of the audit of the financial statements;

(b) The responsibilities of the auditor;

[2a] Under the Corporate Practices (Registration) Rules of the HKICPA, the engagement letter for a corporate practice shall identify the director appointed by the corporate practice to be responsible for the performance of the audit engagement contemplated by the audit report.

(c) The responsibilities of management[2b];

(d) Identification of the applicable financial reporting framework for the preparation of the financial statements; and

(e) Reference to the expected form and content of any reports to be issued by the auditor; and (Ref: Para. A23a)

~~(e)~~(f) ~~a~~ A statement that there may be circumstances in which a report may differ from its expected form and content.

11. If law or regulation prescribes in sufficient detail the terms of the audit engagement referred to in paragraph 10, the auditor need not record them in a written agreement, except for the fact that such law or regulation applies and that management acknowledges and understands its responsibilities as set out in paragraph 6(b). (Ref: Para. A22, A26-A27)

12. If law or regulation prescribes responsibilities of management similar to those described in paragraph 6(b), the auditor may determine that the law or regulation includes responsibilities that, in the auditor's judgment, are equivalent in effect to those set out in that paragraph. For such responsibilities that are equivalent, the auditor may use the wording of the law or regulation to describe them in the written agreement. For those responsibilities that are not prescribed by law or regulation such that their effect is equivalent, the written agreement shall use the description in paragraph 6(b). (Ref: Para. A26)

Recurring Audits

13. On recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement. (Ref: Para. A28)

Acceptance of a Change in the Terms of the Audit Engagement

14. The auditor shall not agree to a change in the terms of the audit engagement where there is no reasonable justification for doing so. (Ref: Para. A29-A31)

15. If, prior to completing the audit engagement, the auditor is requested to change the audit engagement to an engagement that conveys a lower level of assurance, the auditor shall determine whether there is reasonable justification for doing so. (Ref: Para. A32-A33)

16. If the terms of the audit engagement are changed, the auditor and management shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.

17. If the auditor is unable to agree to a change of the terms of the audit engagement and is not permitted by management to continue the original audit engagement, the auditor shall:

(a) Withdraw from the audit engagement where possible under applicable law or regulation; and

(b) Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators[2c].

[2b] Under the Companies Ordinance, directors are responsible for the preparation of financial statements showing a true and fair view.

[2c] Auditor of a company incorporated under the Companies Ordinance who resigns or is removed from the office as auditor or where the auditor's term of office expires and not reappointed is required to comply with the requirements of sections 424 or 425 of the Companies Ordinance regarding the statement to be made by the auditor in relation to the resignation, removal or retirement.

Additional Considerations in Engagement Acceptance

Financial Reporting Standards Supplemented by Law or Regulation

18. If financial reporting standards established by an authorized or recognized standards setting organization are supplemented by law or regulation, the auditor shall determine whether there are any conflicts between the financial reporting standards and the additional requirements. If such conflicts exist, the auditor shall discuss with management the nature of the additional requirements and shall agree whether:

    (a) The additional requirements can be met through additional disclosures in the financial statements; or

    (b) The description of the applicable financial reporting framework in the financial statements can be amended accordingly.

    If neither of the above actions is possible, the auditor shall determine whether it will be necessary to modify the auditor's opinion in accordance with HKSA 705.[3] (Ref: Para. A34)

Financial Reporting Framework Prescribed by Law or Regulation—Other Matters Affecting Acceptance

19. If the auditor has determined that the financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation, the auditor shall accept the audit engagement only if the following conditions are present: (Ref: Para. A35)

    (a) Management agrees to provide additional disclosures in the financial statements required to avoid the financial statements being misleading; and

    (b) It is recognized in the terms of the audit engagement that:

        (i) The auditor's report on the financial statements will incorporate an Emphasis of Matter paragraph, drawing users' attention to the additional disclosures, in accordance with HKSA 706;[4] and

        (ii) Unless the auditor is required by law or regulation to express the auditor's opinion on the financial statements by using the phrases "present fairly, in all material respects," or "give a true and fair view" in accordance with the applicable financial reporting framework, the auditor's opinion on the financial statements will not include such phrases.

20. If the conditions outlined in paragraph 19 are not present and the auditor is required by law or regulation to undertake the audit engagement, the auditor shall:

    (a) Evaluate the effect of the misleading nature of the financial statements on the auditor's report; and

    (b) Include appropriate reference to this matter in the terms of the audit engagement.

[3] HKSA 705, "Modifications to the Opinion in the Independent Auditor’s Report."

[4] HKSA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report."

Auditor's Report Prescribed by Law or Regulation

21. In some cases, law or regulation of the relevant jurisdiction prescribes the layout or wording of the auditor's report in a form or in terms that are significantly different from the requirements of HKSAs. In these circumstances, the auditor shall evaluate:

    (a) Whether users might misunderstand the assurance obtained from the audit of the financial statements and, if so,

    (b) Whether additional explanation in the auditor's report can mitigate possible misunderstanding.[5]

    If the auditor concludes that additional explanation in the auditor's report cannot mitigate possible misunderstanding, the auditor shall not accept the audit engagement, unless required by law or regulation to do so. An audit conducted in accordance with such law or regulation does not comply with HKSAs. Accordingly, the auditor shall not include any reference within the auditor's report to the audit having been conducted in accordance with HKSAs.[6] (Ref: Para. A36-A37)

Conformity and Compliance with International Standards on Auditing

22. As of June 2009 (date of issue), this HKSA conforms with International Standard on Auditing (ISA) 210 "Agreeing the Terms of Audit Engagements". Compliance with the requirements of this HKSA ensures compliance with ISA 210.

23. Additional local guidance and explanations are provided in footnotes 2a, 2b and 2c. An example audit engagement letter is provided in Appendix 1.

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Application and Other Explanatory Material

Scope of this HKSA (Ref: Para. 1)

A1. Assurance engagements, which include audit engagements, may only be accepted when the practitioner considers that relevant ethical requirements such as independence and professional competence will be satisfied, and when the engagement exhibits certain characteristics.[7] The auditor's responsibilities in respect of ethical requirements in the context of the acceptance of an audit engagement and in so far as they are within the control of the auditor are dealt with in HKSA 220.[8] This HKSA deals with those matters (or preconditions) that are within the control of the entity and upon which it is necessary for the auditor and the entity's management to agree.

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5 HKSA 706.

6 See also HKSA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, paragraph ~~43~~50.

7 "Hong Kong Framework for Assurance Engagements," paragraph 17.

8 HKSA 220, paragraphs 9-11.

Preconditions for an Audit

The Financial Reporting Framework (Ref: Para. 6(a))

A2. A condition for acceptance of an assurance engagement is that the criteria referred to in the definition of an assurance engagement are suitable and available to intended users.[9] Criteria are the benchmarks used to evaluate or measure the subject matter including, where relevant, benchmarks for presentation and disclosure. Suitable criteria enable reasonably consistent evaluation or measurement of a subject matter within the context of professional judgment. For purposes of the HKSAs, the applicable financial reporting framework provides the criteria the auditor uses to audit the financial statements, including where relevant their fair presentation.

A3. Without an acceptable financial reporting framework, management does not have an appropriate basis for the preparation of the financial statements and the auditor does not have suitable criteria for auditing the financial statements. In many cases the auditor may presume that the applicable financial reporting framework is acceptable, as described in paragraphs A8-A9.

Determining the Acceptability of the Financial Reporting Framework

A4. Factors that are relevant to the auditor's determination of the acceptability of the financial reporting framework to be applied in the preparation of the financial statements include:

- The nature of the entity (for example, whether it is a business enterprise, a public sector entity or a not-for-profit organization);
- The purpose of the financial statements (for example, whether they are prepared to meet the common financial information needs of a wide range of users or the financial information needs of specific users);
- The nature of the financial statements (for example, whether the financial statements are a complete set of financial statements or a single financial statement); and
- Whether law or regulation prescribes the applicable financial reporting framework.

A5. Many users of financial statements are not in a position to demand financial statements tailored to meet their specific information needs. While all the information needs of specific users cannot be met, there are financial information needs that are common to a wide range of users. Financial statements prepared in accordance with a financial reporting framework designed to meet the common financial information needs of a wide range of users are referred to as general purpose financial statements.

A6. In some cases, the financial statements will be prepared in accordance with a financial reporting framework designed to meet the financial information needs of specific users. Such financial statements are referred to as special purpose financial statements. The financial information needs of the intended users will determine the applicable financial reporting framework in these circumstances. HKSA 800 discusses the acceptability of financial reporting frameworks designed to meet the financial information needs of specific users.[10]

[9] "Hong Kong Framework for Assurance Engagements," paragraph 17(b)(ii).

[10] HKSA 800, "Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks," paragraph 8.

A7. Deficiencies in the applicable financial reporting framework that indicate that the framework is not acceptable may be encountered after the audit engagement has been accepted. When use of that framework is prescribed by law or regulation, the requirements of paragraphs 19-20 apply. When use of that framework is not prescribed by law or regulation, management may decide to adopt another framework that is acceptable. When management does so, as required by paragraph 16, new terms of the audit engagement are agreed to reflect the change in the framework as the previously agreed terms will no longer be accurate.

General purpose frameworks

A8. At present, there is no objective and authoritative basis that has been generally recognized globally for judging the acceptability of general purpose frameworks. In the absence of such a basis, financial reporting standards established by organizations that are authorized or recognized to promulgate standards to be used by certain types of entities are presumed to be acceptable for general purpose financial statements prepared by such entities, provided the organizations follow an established and transparent process involving deliberation and consideration of the views of a wide range of stakeholders. Examples of such financial reporting standards include:

- International/ Hong Kong Financial Reporting Standards (IFRSs/ HKFRSs) promulgated by the International Accounting Standards Board/ the Hong Kong Institute of Certified Public Accountants;
- International Public Sector Accounting Standards (IPSASs) promulgated by the International Public Sector Accounting Standards Board; and
- Accounting principles promulgated by an authorized or recognized standards setting organization in a particular jurisdiction, provided the organization follows an established and transparent process involving deliberation and consideration of the views of a wide range of stakeholders.

These financial reporting standards are often identified as the applicable financial reporting framework in law or regulation governing the preparation of general purpose financial statements.

Financial reporting frameworks prescribed by law or regulation

A9. In accordance with paragraph 6(a), the auditor is required to determine whether the financial reporting framework, to be applied in the preparation of the financial statements, is acceptable. In some jurisdictions, law or regulation may prescribe the financial reporting framework to be used in the preparation of general purpose financial statements for certain types of entities. In the absence of indications to the contrary, such a financial reporting framework is presumed to be acceptable for general purpose financial statements prepared by such entities. In the event that the framework is not considered to be acceptable, paragraphs 19-20 apply.

Jurisdictions that do not have standards setting organizations or prescribed financial reporting frameworks

A10. When an entity is registered or operating in a jurisdiction that does not have an authorized or recognized standards setting organization, or where use of the financial reporting framework is not prescribed by law or regulation, management identifies a financial reporting framework to be applied in the preparation of the financial statements. Appendix 2 contains guidance on determining the acceptability of financial reporting frameworks in such circumstances.

Agreement of the Responsibilities of Management (Ref: Para. 6(b))

A11. An audit in accordance with HKSAs is conducted on the premise that management has acknowledged and understands that it has the responsibilities set out in paragraph 6(b).[11] In certain jurisdictions, such responsibilities may be specified in law or regulation. In others, there may be little or no legal or regulatory definition of such responsibilities. HKSAs do not override law or regulation in such matters. However, the concept of an independent audit requires that the auditor's role does not involve taking responsibility for the preparation of the financial statements or for the entity's related internal control, and that the auditor has a reasonable expectation of obtaining the information necessary for the audit in so far as management is able to provide or procure it. Accordingly, the premise is fundamental to the conduct of an independent audit. To avoid misunderstanding, agreement is reached with management that it acknowledges and understands that it has such responsibilities as part of agreeing and recording the terms of the audit engagement in paragraphs 9-12.

A12. The way in which the responsibilities for financial reporting are divided between management and those charged with governance will vary according to the resources and structure of the entity and any relevant law or regulation, and the respective roles of management and those charged with governance within the entity. In most cases, management is responsible for execution while those charged with governance have oversight of management. In some cases, those charged with governance will have, or will assume, responsibility for approving the financial statements or monitoring the entity's internal control related to financial reporting. In larger or public entities, a subgroup of those charged with governance, such as an audit committee, may be charged with certain oversight responsibilities.

A13. HKSA 580 requires the auditor to request management to provide written representations that it has fulfilled certain of its responsibilities.[12] It may therefore be appropriate to make management aware that receipt of such written representations will be expected, together with written representations required by other HKSAs and, where necessary, written representations to support other audit evidence relevant to the financial statements or one or more specific assertions in the financial statements.

A14. Where management will not acknowledge its responsibilities, or agree to provide the written representations, the auditor will be unable to obtain sufficient appropriate audit evidence.[13] In such circumstances, it would not be appropriate for the auditor to accept the audit engagement, unless law or regulation requires the auditor to do so. In cases where the auditor is required to accept the audit engagement, the auditor may need to explain to management the importance of these matters, and the implications for the auditor's report.

Preparation of the Financial Statements (Ref: Para. 6(b)(i))

A15. Most financial reporting frameworks include requirements relating to the presentation of the financial statements; for such frameworks, *preparation* of the financial statements in accordance with the financial reporting framework includes *presentation*. In the case of a fair presentation framework the importance of the reporting objective of fair presentation is such that the premise agreed with management includes specific reference to fair presentation, or to the responsibility to ensure that the financial statements will "give a true and fair view" in accordance with the financial reporting framework.

[11] HKSA 200, paragraph A2.

[12] HKSA 580, "Written Representations," paragraphs 10-11.

[13] HKSA 580, paragraph A26.

Internal Control (Ref: Para. 6(b)(ii))

A16. Management maintains such internal control as it determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. Internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity's financial reporting objectives due to the inherent limitations of internal control.[14]

A17. An independent audit conducted in accordance with the HKSAs does not act as a substitute for the maintenance of internal control necessary for the preparation of financial statements by management. Accordingly, the auditor is required to obtain the agreement of management that it acknowledges and understands its responsibility for internal control. However, the agreement required by paragraph 6(b)(ii) does not imply that the auditor will find that internal control maintained by management has achieved its purpose or will be free of deficiencies.

A18. It is for management to determine what internal control is necessary to enable the preparation of the financial statements. The term "internal control" encompasses a wide range of activities within components that may be described as the control environment; the entity's risk assessment process; the information system, including the related business processes relevant to financial reporting, and communication; control activities; and monitoring of controls. This division, however, does not necessarily reflect how a particular entity may design, implement and maintain its internal control, or how it may classify any particular component.[15] An entity's internal control (in particular, its accounting books and records, or accounting systems) will reflect the needs of management, the complexity of the business, the nature of the risks to which the entity is subject, and relevant laws or regulation.

A19. In some jurisdictions, law or regulation may refer to the responsibility of management for the adequacy of accounting books and records, or accounting systems. In some cases, general practice may assume a distinction between accounting books and records or accounting systems on the one hand, and internal control or controls on the other. As accounting books and records, or accounting systems, are an integral part of internal control as referred to in paragraph A18, no specific reference is made to them in paragraph 6(b)(ii) for the description of the responsibility of management. To avoid misunderstanding, it may be appropriate for the auditor to explain to management the scope of this responsibility.

Additional Information (Ref: Para. 6(b)(iii)b.)

A19a. Additional information that the auditor may request from management for the purpose of the audit may include when applicable, matters related to other information in accordance with HKSA 720 (Revised). When the auditor expects to obtain other information after the date of the auditor's report, the terms of the audit engagement may also acknowledge the auditor's responsibilities relating to such other information including, if applicable, 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.[*]

Considerations Relevant to Smaller Entities (Ref: Para. 6(b))

A20. One of the purposes of agreeing the terms of the audit engagement is to avoid misunderstanding about the respective responsibilities of management and the auditor. For example, when a third party has assisted with the preparation of the financial statements, it

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14 HKSA 315, "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment," paragraph A46.

15 HKSA 315, paragraph A51 and Appendix 1.

* When the conforming amendment becomes effective, this paragraph will become paragraph A20 and all subsequent paragraphs will be renumbered accordingly.

may be useful to remind management that the preparation of the financial statements in accordance with the applicable financial reporting framework remains its responsibility.

Agreement on Audit Engagement Terms

Agreeing the Terms of the Audit Engagement (Ref: Para. 9)

A21. The roles of management and those charged with governance in agreeing the terms of the audit engagement for the entity depend on the governance structure of the entity and relevant law or regulation.

Audit Engagement Letter or Other Form of Written Agreement[16] (Ref: Para. 10-11)

A22. It is in the interests of both the entity and the auditor that the auditor sends an audit engagement letter before the commencement of the audit to help avoid misunderstandings with respect to the audit. In some countries, however, the objective and scope of an audit and the responsibilities of management and of the auditor may be sufficiently established by law, that is, they prescribe the matters described in paragraph 10. Although in these circumstances paragraph 11 permits the auditor to include in the engagement letter only reference to the fact that relevant law or regulation applies and that management acknowledges and understands its responsibilities as set out in paragraph 6(b), the auditor may nevertheless consider it appropriate to include the matters described in paragraph 10 in an engagement letter for the information of management.

Form and Content of the Audit Engagement Letter

A23. The form and content of the audit engagement letter may vary for each entity. Information included in the audit engagement letter on the auditor's responsibilities may be based on HKSA 200.[17] Paragraphs 6(b) and 12 of this HKSA deal with the description of the responsibilities of management. In addition to including the matters required by paragraph 10, an audit engagement letter may make reference to, for example:

- Elaboration of the scope of the audit, including reference to applicable legislation, regulations, HKSAs, and ethical and other pronouncements of professional bodies to which the auditor adheres.
- The form of any other communication of results of the audit engagement.
- The requirement for the auditor to communicate key audit matters in the auditor's report in accordance with HKSA 701.[18]
- The fact that because of the inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with HKSAs.
- Arrangements regarding the planning and performance of the audit, including the composition of the engagement team.
- The expectation that management will provide written representations (see also paragraph A13).

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[16] In the paragraphs that follow, any reference to an audit engagement letter is to be taken as a reference to an audit engagement letter or other suitable form of written agreement.

[17] HKSA 200, paragraphs 3-9.

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

- The agreement of management to make available to the auditor draft financial statements and any accompanying other information in time to allow the auditor to complete the audit in accordance with the proposed timetable.

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

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

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

<u>A23a. When the auditor is not required to communicate key audit matters, it may be helpful for the auditor to make reference in the terms of the audit engagement to the possibility of communicating key audit matters in the auditor's report and, in certain jurisdictions, it may be necessary for the auditor to include a reference to such possibility in order to retain the ability to do so.</u>

A24. When relevant, the following points could also be made in the audit engagement letter:

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

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

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

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

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

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

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

Audits of Components

A25. When the auditor of a parent entity is also the auditor of a component, the factors that may influence the decision whether to send a separate audit engagement letter to the component include the following:

- Who appoints the component auditor;

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

- Legal requirements in relation to audit appointments;

- Degree of ownership by parent; and

- Degree of independence of the component management from the parent entity.

Responsibilities of Management Prescribed by Law or Regulation (Ref: Para. 11-12)

A26. If, in the circumstances described in paragraphs A22 and A27, the auditor concludes that it is not necessary to record certain terms of the audit engagement in an audit engagement letter, the auditor is still required by paragraph 11 to seek the written agreement from management that it acknowledges and understands that it has the responsibilities set out in paragraph 6(b). However, in accordance with paragraph 12, such written agreement may use the wording of the law or regulation if such law or regulation establishes responsibilities for management that are equivalent in effect to those described in paragraph 6(b). The accounting profession, audit standards setter, or audit regulator in a jurisdiction may have provided guidance as to whether the description in law or regulation is equivalent.

Considerations specific to public sector entities

A27. Law or regulation governing the operations of public sector audits generally mandate the appointment of a public sector auditor and commonly set out the public sector auditor's responsibilities and powers, including the power to access an entity's records and other information. When law or regulation prescribes in sufficient detail the terms of the audit engagement, the public sector auditor may nonetheless consider that there are benefits in issuing a fuller audit engagement letter than permitted by paragraph 11.

Recurring Audits (Ref: Para. 13)

A28. The auditor may decide not to send a new audit engagement letter or other written agreement each period. However, the following factors may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms:

- Any indication that the entity misunderstands the objective and scope of the audit.
- Any revised or special terms of the audit engagement.
- A recent change of senior management.
- A significant change in ownership.
- A significant change in nature or size of the entity's business.
- A change in legal or regulatory requirements.
- A change in the financial reporting framework adopted in the preparation of the financial statements.
- A change in other reporting requirements.

Acceptance of a Change in the Terms of the Audit Engagement

Request to Change the Terms of the Audit Engagement (Ref: Para. 14)

A29. A request from the entity for the auditor to change the terms of the audit engagement may result from a change in circumstances affecting the need for the service, a misunderstanding as to the nature of an audit as originally requested or a restriction on the scope of the audit engagement, whether imposed by management or caused by other circumstances. The auditor, as required by paragraph 14, considers the justification given for the request, particularly the implications of a restriction on the scope of the audit engagement.

A30. A change in circumstances that affects the entity's requirements or a misunderstanding concerning the nature of the service originally requested may be considered a reasonable basis for requesting a change in the audit engagement.

A31. In contrast, a change may not be considered reasonable if it appears that the change relates to information that is incorrect, incomplete or otherwise unsatisfactory. An example might be where the auditor is unable to obtain sufficient appropriate audit evidence regarding receivables and the entity asks for the audit engagement to be changed to a review engagement to avoid a qualified opinion or a disclaimer of opinion.

Request to Change to a Review or a Related Service (Ref: Para. 15)

A32. Before agreeing to change an audit engagement to a review or a related service, an auditor who was engaged to perform an audit in accordance with HKSAs may need to assess, in addition to the matters referred to in paragraphs A29-A31 above, any legal or contractual implications of the change.

A33. If the auditor concludes that there is reasonable justification to change the audit engagement to a review or a related service, the audit work performed to the date of change may be relevant to the changed engagement; however, the work required to be performed and the report to be issued would be those appropriate to the revised engagement. In order to avoid confusing the reader, the report on the related service would not include reference to:

(a) The original audit engagement; or

(b) Any procedures that may have been performed in the original audit engagement, except where the audit engagement is changed to an engagement to undertake agreed-upon procedures and thus reference to the procedures performed is a normal part of the report.

Additional Considerations in Engagement Acceptance

Financial Reporting Standards Supplemented by Law or Regulation (Ref: Para. 18)

A34. In some jurisdictions, law or regulation may supplement the financial reporting standards established by an authorized or recognized standards setting organization with additional requirements relating to the preparation of financial statements. In those jurisdictions, the applicable financial reporting framework for the purposes of applying the HKSAs encompasses both the identified financial reporting framework and such additional requirements provided they do not conflict with the identified financial reporting framework. This may, for example, be the case when law or regulation prescribes disclosures in addition to those required by the financial reporting standards or when they narrow the range of acceptable choices that can be made within the financial reporting standards.[19]

Financial Reporting Framework Prescribed by Law or Regulation—Other Matters Affecting Acceptance (Ref: Para. 19)

A35. Law or regulation may prescribe that the wording of the auditor's opinion use the phrases "present fairly, in all material respects" or "give a true and fair view" in a case where the auditor concludes that the applicable financial reporting framework prescribed by law or regulation would otherwise have been unacceptable. In this case, the terms of the prescribed wording of the auditor's report are significantly different from the requirements of HKSAs (see paragraph 21).

[19] HKSA 700, paragraph 15, includes a requirement regarding the evaluation of whether the financial statements adequately refer to or describe the applicable financial reporting framework.

Auditor's Report Prescribed by Law or Regulation (Ref: Para. 21)

A36. HKSAs require that the auditor shall not represent compliance with HKSAs unless the auditor has complied with all of the HKSAs relevant to the audit.[20] When law or regulation prescribes the layout or wording of the auditor's report in a form or in terms that are significantly different from the requirements of HKSAs and the auditor concludes that additional explanation in the auditor's report cannot mitigate possible misunderstanding, the auditor may consider including a statement in the auditor's report that the audit is not conducted in accordance with HKSAs. The auditor is, however, encouraged to apply HKSAs, including the HKSAs that address the auditor's report, to the extent practicable, notwithstanding that the auditor is not permitted to refer to the audit being conducted in accordance with HKSAs.

Considerations Specific to Public Sector Entities

A37. In the public sector, specific requirements may exist within the legislation governing the audit mandate; for example, the auditor may be required to report directly to a minister, the legislature or the public if the entity attempts to limit the scope of the audit.

[20] HKSA 200, paragraph 20.

Appendix 1

Example of an Audit Engagement Letter

The following is an example of an audit engagement letter for an audit of general purpose financial statements of a company which is incorporated in Hong Kong under the Companies Ordinance but do not take advantage of the reporting exemption in the Companies Ordinance. This letter is not authoritative but is intended only to be a guide that may be used in conjunction with the considerations outlined in this HKSA. It will need to be varied according to individual requirements and circumstances, for example to the special reporting requirements of regulated entities. It may be appropriate to seek legal advice that any proposed letter is suitable.

To the directors of [ABC Company Limited]:

Objective of services

1.1 ~~1.1~~ You have requested that we audit the (consolidated)* financial statements of ABC Company Limited ("the Company") (and its subsidiaries)*. We are pleased to confirm our acceptance and our understanding of this audit engagement by means of this letter.

1.2 ~~Our audit will be conducted with t~~The objectives of our audit are to obtain reasonable assurance about whether the (consolidated)* financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our ~~expressing an~~ opinion ~~on the (consolidated)* financial statements~~. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Hong Kong Standards on Auditing ("HKSAs") will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these (consolidated)* financial statements.

Responsibilities of directors

2.1 Our audit will be conducted on the basis that you acknowledge and understand that you have responsibility:

a. To prepare (consolidated)* financial statements which give a true and fair view of the financial position of the Company (and its subsidiaries)* as at the end of the financial year and of [its][their] financial performance for the financial year in accordance with [*insert applicable financial reporting framework*] [*Hong Kong Financial Reporting Standards*][*Hong Kong Financial Reporting Standard for Private Entities*] and the Companies Ordinance ("CO");

b. (To ensure the subsidiary, if any, of the Company keeps accounting records that are sufficient for the Company to prepare (consolidated)* financial statements that comply with a. above.)*

c. To take all reasonable steps to ensure the Company keeps sufficient accounting records which show and explain the transactions of the Company (and its subsidiaries)*, disclose with reasonable accuracy, at any time, the financial position and financial performance of the Company (and its subsidiaries)*;

d. To ensure that the (consolidated)* financial statements comply with section 383 (Notes to Financial Statements to Contain Information on Directors' Emoluments etc) of the CO which must contain in the notes to the financial statements, the information prescribed by the Companies (Disclosure of Information about Benefits of Directors) Regulation (Cap. 622G);

e. For such internal control as you determine is necessary to enable the preparation of (consolidated)* financial statements that are free from material misstatement, whether due to fraud or error;

f. To provide us with:

   (i) Access to all information of which you are aware that is relevant to the preparation of the (consolidated)* financial statements such as Company's accounting records and all other relevant records and documentation, including minutes of all management and shareholders' meetings and other matters;

   (ii) Additional information that we may request from you for the purpose of the audit; and

   (iii) Unrestricted access to persons related to the Company (and its subsidiaries)* from whom we determine it necessary to obtain audit evidence;

g. To provide us with (i) any proposed written resolution and (ii) any other document relating to the resolution that is required to be sent to a member of the Company, on or before the circulation of written resolution to a member of the Company; and

h. To notify us any passed written resolution within 15 days after resolution is passed.

2.2 You are also responsible for the preparation and approval of the directors' report in accordance with the CO.

Responsibilities of the auditor

3.1 We have a statutory responsibility to prepare a report to the members to state whether in our opinion the (consolidated)* financial statements give a true and fair view of the financial position and financial performance of the Company (and its subsidiaries)* for the financial year and whether they have been properly prepared in compliance with the CO. We shall also state our opinion in the auditor's report if we are of the opinion that:

a. adequate accounting records have not been kept by the Company (and its subsidiaries)*; or

b. the (consolidated)* financial statements are not in agreement with the accounting records in any material respect; and

We shall also state the fact in the auditor's report if we have failed to obtain all the information and explanations that, to the best of our knowledge and belief, are necessary and material for the purpose of the audit.

In addition, where the (consolidated)* financial statements do not contain information relating to directors' remuneration or loans to officers under section 383(1) of the CO, the CO requires us to include in our report, as far as we are reasonably able to do so, a statement giving the particulars that are required to be, but have not been, contained in the (consolidated)* financial statements.

3.2 We have a professional responsibility to report if the (consolidated)* financial statements do not comply in any material respect with [*insert applicable financial reporting framework*] [*Hong Kong Financial Reporting Standards*][*Hong Kong Financial Reporting Standard for Private Entities*], unless in our opinion the noncompliance is justified in the circumstances. In determining whether or not the departure is justified, we consider:

a. whether the departure is required in order for the (consolidated)* financial statements to give a true and fair view; and

b. whether adequate disclosure has been made concerning the departure.

3.3 We are required to read the information in the directors' report for the financial year to identify and report inconsistencies with the (consolidated)* financial statements. As required by the CO, if we are of the opinion that the information in the directors' report for a financial year is not consistent with the (consolidated)* financial statements for the financial year, we shall state that opinion in our auditor's report; and we may bring that opinion to the members' attention at a general meeting. However, we are not required to audit or review the director's report and accordingly we will not express an opinion or review conclusion or any assurance on it.

Scope of audit

4.1 Our audit will be conducted in accordance with ~~Hong Kong Standards on Auditing (~~"HKSAs~~")~~ issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements. As part of an audit in accordance with HKSAs, we exercise professional judgment and maintain professional skepticism throughout ~~and plan and perform~~ the audit ~~to obtain reasonable assurance about whether the (consolidated)* financial statements are free from material misstatement~~. ~~An audit involves~~We also:

a. ~~performing procedures to obtain audit evidence about the amounts and disclosures in the (consolidated)* financial statements. The procedures selected depend on the auditors judgment, including the assessment of~~Identify and assess the risks of material misstatement of the (consolidated)* financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

b. Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.[1] However, we will communicate to you in writing concerning any significant deficiencies in internal control relevant to the audit of the (consolidated)* financial statements that we have identified during the audit. Any such report may not be provided to third parties without our prior written consent. Such consent will be granted only on the basis that such reports are not prepared with the interests of anyone other than the Company in mind and that we accept no duty or responsibility to any other party as concerns the reports.

c. ~~An audit also includes evaluating~~Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by you.~~, as well as~~

d. Conclude on the appropriateness of your use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's

[1] This sentence would be modified, as appropriate, in circumstances when the auditor also has responsibility to issue an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements

report. However, future events or conditions may cause the Company to cease to continue as a going concern.

e. ~~evaluating~~ Evaluate the overall presentation, structure and content of the (consolidated)* financial statements, including the disclosures, and whether the (consolidated)* financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

4.2 Because of the inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with HKSAs.

~~4.3 In making our risk assessments, we consider internal control relevant to the entity's preparation of the (consolidated)* financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. However, we will communicate to you in writing concerning any significant deficiencies in internal control relevant to the audit of the (consolidated)* financial statements that we have identified during the audit. Any such report may not be provided to third parties without our prior written consent. Such consent will be granted only on the basis that such reports are not prepared with the interests of anyone other than the Company in mind and that we accept no duty or responsibility to any other party as concerns the reports.~~

(4.~~4~~3 In connection with the audit of the consolidated financial statements, we draw your attention to section 412 of the CO which gives the rights to the auditor of the holding company to require a person that is a related entity of the company to provide any information or explanation that the auditor reasonably requires for the performance of the duties as auditor of the holding company. As defined in section 412 of the CO, a related entity includes an auditor of a subsidiary undertaking.

4.~~5~~4 In order to express an opinion on the consolidated financial statements which include the financial information of subsidiaries, joint arrangements or associates of which we are not the auditor, it will be necessary for us to communicate directly with the other auditor(s) concerned to satisfy ourselves that:

a. so far as is practicable, there is uniformity within the Company and its subsidiaries in the application of accounting policies;

b. the consolidated financial statements contain the information required by the CO, applicable accounting standards and any other legislation or non-statutory requirements affecting the presentation of financial statements; and

c. all material aspects of the consolidated financial statements have been subjected to an audit, the nature and extent of which is adequate and reasonable, in our view, for the purpose of forming an opinion on the consolidated financial statements.)*

4.~~6~~ 5 As part of our audit procedures, we will request you to provide written confirmation concerning representations which we have received from you during the course of the audit in connection with the audit. In connection with representations and the supply of information to us generally, we draw your attention to section 412 of the CO which sets out the rights of the auditor in relation to obtaining information from a person that is a related entity as defined in this section of the CO. You are also referred to section 413 of the CO which sets out the offences relating to section 412 of the CO.

4.~~7~~ 6 In order to assist us with the audit of your (consolidated)* financial statements, we shall request sight of all documents or statements, including the chairman's statement, operating and financial review and the directors' report, which are due to be issued with the (consolidated)* financial statements. We are also entitled to attend all general meetings of the Company and to receive notice of all such meetings.

4.~~8~~ 7 The responsibility for safeguarding the assets of the Company (and its subsidiaries)* and for the prevention and detection of fraud, error and non-compliance with law or regulations rests with you. However, we shall endeavour to plan our audit so that we have a reasonable expectation of detecting material misstatements in the (consolidated)* financial statements or books of account (including those resulting from fraud, error or non-compliance with law or regulations), but our audit should not be relied upon to disclose all such material misstatements or frauds, errors or instances of non-compliance as may exist.

4.~~9~~ 8 (Where appropriate - Note) We shall not be treated as having notice, for the purposes of our audit responsibilities, of information provided to members of our firm other than those engaged on the audit (for example information provided in connection with accounting, taxation and other services).

4.~~10~~9 Once we have issued our report we have no further direct responsibility in relation to the (consolidated)* financial statements for that period. However, you agree that you will inform us of any material event occurring between the date of our report and that of the Annual General Meeting which may affect the (consolidated)* financial statements.

Reporting

5.1 [*Insert appropriate reference to the expected form and content of the auditor's report including, if applicable, the reporting on other information in accordance with HKSA 720 (Revised).*]

5.2 The form and content of our report may need to be amended in the light of our audit findings.

(Other services

6. You have requested that we provide other services in respect of ...... The terms under which we provide these other services are dealt with in a separate letter.)*

Fees

7. Our fees are computed on the basis of the time spent on your affairs by our partners and our staff and on the levels of skill and responsibility involved plus out-of-pocket expenses. Unless otherwise agreed, our fees will be billed at appropriate intervals during the course of the audit and will be due on presentation.

Agreement of terms

8.1 Once it has been agreed, this letter will remain effective, from one audit appointment to another, until it is replaced. Please sign and return the enclosed copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our audit of the (consolidated)* financial statements including our respective responsibilities.

(8.2 Since the terms of our engagement as auditors of the subsidiaries listed in the attached appendix are the same, we will not send separate letters to the board of directors of each subsidiary. We would therefore be grateful if you would forward copies of this letter to the boards of directors of each such subsidiary and confirm that these boards have also agreed and confirmed their acceptance of this letter.)*

Yours faithfully,

ABC & Co.

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

Date

We agree to the terms of this letter.

(Signed)

....
Director, for and on behalf of the board of

Date

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* Delete where not applicable.

Note

When accounting, taxation or other services are undertaken on behalf of an audit client, information may be provided to members of the audit firm other than those engaged on the audit. In such cases, it may be appropriate for the audit engagement letter to include this or a similar paragraph to indicate that the auditor is not to be treated as having notice, for the purposes of the auditor's responsibilities, of such information, to make it clear that a company would not be absolved from informing the auditor directly of a material matter.

Appendix 2

(Ref: Para. A10)

Determining the Acceptability of General Purpose Frameworks

Jurisdictions that Do Not Have Authorized or Recognized Standards Setting Organizations or Financial Reporting Frameworks Prescribed by Law or Regulation

1. As explained in paragraph A10 of this HKSA, when an entity is registered or operating in a jurisdiction that does not have an authorized or recognized standards setting organization, or where use of the financial reporting framework is not prescribed by law or regulation, management identifies an applicable financial reporting framework. Practice in such jurisdictions is often to use the financial reporting standards established by one of the organizations described in paragraph A8 of this HKSA.

2. Alternatively, there may be established accounting conventions in a particular jurisdiction that are generally recognized as the financial reporting framework for general purpose financial statements prepared by certain specified entities operating in that jurisdiction. When such a financial reporting framework is adopted, the auditor is required by paragraph 6(a) of this HKSA to determine whether the accounting conventions collectively can be considered to constitute an acceptable financial reporting framework for general purpose financial statements. When the accounting conventions are widely used in a particular jurisdiction, the accounting profession in that jurisdiction may have considered the acceptability of the financial reporting framework on behalf of the auditors. Alternatively, the auditor may make this determination by considering whether the accounting conventions exhibit attributes normally exhibited by acceptable financial reporting frameworks (see paragraph 3 below), or by comparing the accounting conventions to the requirements of an existing financial reporting framework considered to be acceptable (see paragraph 4 below).

3. Acceptable financial reporting frameworks normally exhibit the following attributes that result in information provided in financial statements that is useful to the intended users:

    (a) Relevance, in that the information provided in the financial statements is relevant to the nature of the entity and the purpose of the financial statements. For example, in the case of a business enterprise that prepares general purpose financial statements, relevance is assessed in terms of the information necessary to meet the common financial information needs of a wide range of users in making economic decisions. These needs are ordinarily met by presenting the financial position, financial performance and cash flows of the business enterprise.

    (b) Completeness, in that transactions and events, account balances and disclosures that could affect conclusions based on the financial statements are not omitted.

    (c) Reliability, in that the information provided in the financial statements:

        (i) Where applicable, reflects the economic substance of events and transactions and not merely their legal form; and

        (ii) Results in reasonably consistent evaluation, measurement, presentation and disclosure, when used in similar circumstances.

    (d) Neutrality, in that it contributes to information in the financial statements that is free from bias.

(e) Understandability, in that the information in the financial statements is clear and comprehensive and not subject to significantly different interpretation.

4. The auditor may decide to compare the accounting conventions to the requirements of an existing financial reporting framework considered to be acceptable. For example, the auditor may compare the accounting conventions to HKFRSs. For an audit of a small entity, the auditor may decide to compare the accounting conventions to a financial reporting framework specifically developed for such entities by an authorized or recognized standards setting organization. When the auditor makes such a comparison and differences are identified, the decision as to whether the accounting conventions adopted in the preparation of the financial statements constitute an acceptable financial reporting framework includes considering the reasons for the differences and whether application of the accounting conventions, or the description of the financial reporting framework in the financial statements, could result in financial statements that are misleading.

5. A conglomeration of accounting conventions devised to suit individual preferences is not an acceptable financial reporting framework for general purpose financial statements. Similarly, a compliance framework will not be an acceptable financial reporting framework, unless it is generally accepted in the particular jurisdictions by preparers and users.

HKSA 220
Issued June 2009; revised July 2010, May 2013,
February 2015*, August 2015**

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

Hong Kong Standard on Auditing 220

Quality Control for an Audit of Financial Statements

** Conforming amendments have been made to this HKSA as a result of the new and revised HKSAs issued in Update 172, and will become effective for audits of financial statements for periods ending on or after 15 December 2016. The conforming amendments are underlined for easy reference.

* Conforming amendments have been made to this HKSA as a result of HKSA 610 (Revised 2013), *Using the Work of Internal Auditors*, and are effective for audits of financial statements for periods ended on or after 15 December 2014. The conforming amendments are set out in the Consolidated Table of Changes in Update 166 issued in February 2015.

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

HONG KONG STANDARD ON AUDITING 220

QUALITY CONTROL FOR AN AUDIT OF FINANCIAL STATEMENTS

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

CONTENTS

Hong Kong Standard on Auditing (HKSA) 220, "Quality Control for an Audit of Financial Statements" should be read in conjunction with HKSA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing."

Introduction

Scope of this HKSA

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

System of Quality Control and Role of Engagement Teams

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

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

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

   This HKSA is premised on the basis that the firm is subject to HKSQC 1~~ or to national requirements that are at least as demanding~~. (Ref: Para. A1)

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

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

Effective Date

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

Objective

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

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

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

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

Definitions

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

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

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

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

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

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

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

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

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

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

   (j) Network – A larger structure:

      (i) That is aimed at cooperation, and

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

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

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

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

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

(l) Personnel – Partners and staff.

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

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

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

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

Requirements

Leadership Responsibilities for Quality on Audits

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

Relevant Ethical Requirements

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

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

Independence

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

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

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

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

Acceptance and Continuance of Client Relationships and Audit Engagements

12. The engagement partner shall be satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and audit engagements have been followed, and shall determine that conclusions reached in this regard are appropriate. (Ref: Para. A8-A9)

13. If the engagement partner obtains information that would have caused the firm to decline the audit engagement had that information been available earlier, the engagement partner shall communicate that information promptly to the firm, so that the firm and the engagement partner can take the necessary action. (Ref: Para. A9)

Assignment of Engagement Teams

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

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

    (b) Enable an auditor's report that is appropriate in the circumstances to be issued. (Ref: Para. A10-A12)

Engagement Performance

Direction, Supervision and Performance

15. The engagement partner shall take responsibility for:

    (a) The direction, supervision and performance of the audit engagement in compliance with professional standards and applicable legal and regulatory requirements; and (Ref: Para. A13-A15, A20)

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

Reviews

16. The engagement partner shall take responsibility for reviews being performed in accordance with the firm's review policies and procedures. (Ref: Para. A16-A17, A20)

17. On or before the date of the auditor's report, the engagement partner shall, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued. (Ref: Para. A18-A20)

Consultation

18. The engagement partner shall:

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

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

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

    (d) Determine that conclusions resulting from such consultations have been implemented. (Ref: Para. A21-A22)

Engagement Quality Control Review

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

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

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

    (c) Not date the auditor's report until the completion of the engagement quality control review. (Ref: Para. A23-A25)

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

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

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

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

    (d) Evaluation of the conclusions reached in formulating the auditor's report and consideration of whether the proposed auditor's report is appropriate. (Ref: Para. A26-A27a, A29-A31)

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

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

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

(c) Whether audit documentation selected for review reflects the work performed in relation to the significant judgments and supports the conclusions reached. (Ref: Para. A28-A31)

Differences of Opinion

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

Monitoring

23. An effective system of quality control includes a monitoring process designed to provide the firm with reasonable assurance that its policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively. The engagement partner shall consider the results of the firm's monitoring process as evidenced in the latest information circulated by the firm and, if applicable, other network firms and whether deficiencies noted in that information may affect the audit engagement. (Ref: Para A32-A34)

Documentation

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

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

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

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

    (d) The nature and scope of, and conclusions resulting from, consultations undertaken during the course of the audit engagement. (Ref: Para. A35)

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

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

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

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

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

Conformity and Compliance with International Standards on Auditing

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

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Application and Other Explanatory Material

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

A1. HKSQC 1~~, or national requirements that are at least as demanding,~~ deals with the firm's responsibilities to establish and maintain its system of quality control for audit engagements. The system of quality control includes policies and procedures that address each of the following elements:

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

HKSQC 1 contains ~~National~~ requirements which are at least as demanding as its international equivalent, ISQC 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*[*], ~~that deal with the firm's responsibilities to establish and maintain a system of quality control are at least as demanding~~ as it~~HKSQC 1 when they~~ addresses all the elements referred to in ~~this paragraph~~ISQC 1 and imposes obligations on the firm that achieve the aims of the requirements set out in ~~HK~~I[*]SQC 1.

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

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

- Competence of personnel through their recruitment and formal training.
- Independence through the accumulation and communication of relevant independence information.
- Maintenance of client relationships through acceptance and continuance systems.
- Adherence to applicable legal and regulatory requirements through the monitoring process.

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

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

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

(a) The importance to audit quality of:

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

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

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

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

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

Relevant Ethical Requirements

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

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

(a) Integrity;

(b) Objectivity;

(c) Professional competence and due care;

(d) Confidentiality; and

(e) Professional behavior.

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

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

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

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

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

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

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

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

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

Considerations Specific to Public Sector Entities

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

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

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

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

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

A9. In the public sector, auditors may be appointed in accordance with statutory procedures. Accordingly, certain of the requirements and considerations regarding the acceptance and continuance of client relationships and audit engagements as set out in paragraphs 12, 13 and A8 may not be relevant. Nonetheless, information gathered as a result of the process described may be valuable to public sector auditors in performing risk assessments and in carrying out reporting responsibilities.

Assignment of Engagement Teams (Ref: Para. 14)

A10. An engagement team includes a person using expertise in a specialized area of accounting or auditing, whether engaged or employed by the firm, if any, who performs audit procedures on the engagement. However, a person with such expertise is not a member of the engagement team if that person's involvement with the engagement is only consultation. Consultations are addressed in paragraphs 18, A21 and A22.

[6] HKSQC 1, paragraph 27(a).

A11. When considering the appropriate competence and capabilities expected of the engagement team as a whole, the engagement partner may take into consideration such matters as the team's:

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

Considerations Specific to Public Sector Entities

A12. In the public sector, additional appropriate competence may include skills that are necessary to discharge the terms of the audit mandate in a particular jurisdiction. Such competence may include an understanding of the applicable reporting arrangements, including reporting to the legislature or other governing body or in the public interest. The wider scope of a public sector audit may include, for example, some aspects of performance auditing or a comprehensive assessment of compliance with law, regulation or other authority and preventing and detecting fraud and corruption.

Engagement Performance

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

A13. Direction of the engagement team involves informing the members of the engagement team of matters such as:

- Their responsibilities, including the need to comply with relevant ethical requirements, and to plan and perform an audit with professional skepticism as required by HKSA 200.[7]
- Responsibilities of respective partners where more than one partner is involved in the conduct of an audit engagement.
- The objectives of the work to be performed.
- The nature of the entity's business.
- Risk-related issues.
- Problems that may arise.
- The detailed approach to the performance of the engagement.

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

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

A14. Appropriate teamwork and training assist less experienced members of the engagement team to clearly understand the objectives of the assigned work.

A15. Supervision includes matters such as:

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

Reviews

Review Responsibilities (Ref: Para. 16)

A16. Under HKSQC 1, the firm's review responsibility policies and procedures are determined on the basis that work of less experienced team members is reviewed by more experienced team members.[8]

A17. A review consists of consideration whether, for example:

- The work has been performed in accordance with professional standards and applicable legal and regulatory requirements;
- Significant matters have been raised for further consideration;
- Appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- There is a need to revise the nature, timing and extent of work performed;
- The work performed supports the conclusions reached and is appropriately documented;
- The evidence obtained is sufficient and appropriate to support the auditor's report; and
- The objectives of the engagement procedures have been achieved.

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

A18. Timely reviews of the following by the engagement partner at appropriate stages during the engagement allow significant matters to be resolved on a timely basis to the engagement partner's satisfaction on or before the date of the auditor's report:

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8 HKSQC 1, paragraph 33.

- Critical areas of judgment, especially those relating to difficult or contentious matters identified during the course of the engagement;

- Significant risks; and

- Other areas the engagement partner considers important.

The engagement partner need not review all audit documentation, but may do so. However, as required by HKSA 230, the partner documents the extent and timing of the reviews.[9]

A19. An engagement partner taking over an audit during the engagement may apply the review procedures as described in paragraph A18 to review the work performed to the date of a change in order to assume the responsibilities of an engagement partner.

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

A20. Where a member of the engagement team with expertise in a specialized area of accounting or auditing is used, direction, supervision and review of that engagement team member's work may include matters such as:

- Agreeing with that member the nature, scope and objectives of that member's work; and the respective roles of, and the nature, timing and extent of communication between that member and other members of the engagement team.

- Evaluating the adequacy of that member's work including the relevance and reasonableness of that member's findings or conclusions and their consistency with other audit evidence.

Consultation (Ref: Para. 18)

A21. Effective consultation on significant technical, ethical and other matters within the firm or, where applicable, outside the firm can be achieved when those consulted:

- Are given all the relevant facts that will enable them to provide informed advice; and

- Have appropriate knowledge, seniority and experience.

A22. It may be appropriate for the engagement team to consult outside the firm, for example, where the firm lacks appropriate internal resources. They may take advantage of advisory services provided by other firms, professional and regulatory bodies, or commercial organizations that provide relevant quality control services.

Engagement Quality Control Review

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

A23. HKSA 700 requires the auditor's report to be dated no earlier than the date on which the auditor has obtained sufficient appropriate evidence on which to base the auditor's opinion on the financial statements.[10] In cases of an audit of financial statements of listed entities or when an engagement meets the criteria for an engagement quality control review, such a review assists the auditor in determining whether sufficient appropriate evidence has been obtained.

[9] HKSA 230, paragraph 9(c).

[10] HKSA 700, "Forming an Opinion and Reporting on Financial Statements," paragraph 41.

A24. Conducting the engagement quality control review in a timely manner at appropriate stages during the engagement allows significant matters to be promptly resolved to the engagement quality control reviewer's satisfaction on or before the date of the auditor's report.

A25. Completion of the engagement quality control review means the completion by the engagement quality control reviewer of the requirements in paragraphs 20-21, and where applicable, compliance with paragraph 22. Documentation of the engagement quality control review may be completed after the date of the auditor's report as part of the assembly of the final audit file. HKSA 230 establishes requirements and provides guidance in this regard.[11]

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

A26. Remaining alert for changes in circumstances allows the engagement partner to identify situations in which an engagement quality control review is necessary, even though at the start of the engagement, such a review was not required.

A27. The extent of the engagement quality control review may depend, among other things, on the complexity of the audit engagement, whether the entity is a listed entity, and the risk that the auditor's report might not be appropriate in the circumstances. The performance of an engagement quality control review does not reduce the responsibilities of the engagement partner for the audit engagement and its performance.

A27a. When HKSA 701[12] applies, the conclusions reached by the engagement team in formulating the auditor's report include determining:

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

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

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

A28. Other matters relevant to evaluating the significant judgments made by the engagement team that may be considered in an engagement quality control review of a listed entity include:

- Significant risks identified during the engagement in accordance with HKSA 315 (Revised),[13] and the responses to those risks in accordance with HKSA 330,[14] including the engagement team's assessment of, and response to, the risk of fraud in accordance with HKSA 240.[15]

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

[11] HKSA 230, paragraphs 14-16.

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

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

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

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

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

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

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

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

A29. In addition to the audits of financial statements of listed entities, an engagement quality control review is required for audit engagements that meet the criteria established by the firm that subjects engagements to an engagement quality control review. In some cases, none of the firm's audit engagements may meet the criteria that would subject them to such a review.

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

A30. In the public sector, a statutorily appointed auditor (for example, an Auditor General, or other suitably qualified person appointed on behalf of the Auditor General), may act in a role equivalent to that of engagement partner with overall responsibility for public sector audits. In such circumstances, where applicable, the selection of the engagement quality control reviewer includes consideration of the need for independence from the audited entity and the ability of the engagement quality control reviewer to provide an objective evaluation.

A31. Listed entities as referred to in paragraphs 21 and A28 are not common in the public sector. However, there may be other public sector entities that are significant due to size, complexity or public interest aspects, and which consequently have a wide range of stakeholders. Examples include state owned corporations and public utilities. Ongoing transformations within the public sector may also give rise to new types of significant entities. There are no fixed objective criteria on which the determination of significance is based. Nonetheless, public sector auditors evaluate which entities may be of sufficient significance to warrant performance of an engagement quality control review.

Monitoring (Ref: Para. 23)

A32. HKSQC 1 requires the firm to establish a monitoring process designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate and operating effectively.[16]

A33. In considering deficiencies that may affect the audit engagement, the engagement partner may have regard to measures the firm took to rectify the situation that the engagement partner considers are sufficient in the context of that audit.

A34. A deficiency in the firm's system of quality control does not necessarily indicate that a particular audit engagement was not performed in accordance with professional standards and applicable legal and regulatory requirements, or that the auditor's report was not appropriate.

Documentation

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

A35. Documentation of consultations with other professionals that involve difficult or contentious matters that is sufficiently complete and detailed contributes to an understanding of:

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[16] HKSQC 1, paragraph 48.

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

HKSA 230

Issued June 2009; revised July 2010, May 2013, February 2015*, August 2015**

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

Hong Kong Standard on Auditing 230

Audit Documentation

** Conforming amendments have been made to this HKSA as a result of the new and revised HKSAs issued in Update 172, and will become effective for audits of financial statements for periods ending on or after 15 December 2016. The conforming amendments are underlined for easy reference.

* Conforming amendments have been made to this HKSA as a result of HKSA 610 (Revised), *Using the Work of Internal Auditors*, and are effective for audits of financial statements for periods ended on or after 15 December 2013. The conforming amendments are set out in the Consolidated Table of Changes in Update 166 issued in February 2015.

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

HONG KONG STANDARD ON AUDITING 230

AUDIT DOCUMENTATION

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

CONTENTS

Hong Kong Standard on Auditing (HKSA) 230, "Audit Documentation" should be read in conjunction with HKSA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing."

Introduction

Scope of this HKSA

1. This Hong Kong Standard on Auditing (HKSA) deals with the auditor's responsibility to prepare audit documentation for an audit of financial statements. The Appendix lists other HKSAs that contain specific documentation requirements and guidance. The specific documentation requirements of other HKSAs do not limit the application of this HKSA. Law or regulation may establish additional documentation requirements.

Nature and Purposes of Audit Documentation

2. Audit documentation that meets the requirements of this HKSA and the specific documentation requirements of other relevant HKSAs provides:

    (a) Evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor; [1] and

    (b) Evidence that the audit was planned and performed in accordance with HKSAs and applicable legal and regulatory requirements.

3. Audit documentation serves a number of additional purposes, including the following:

    - Assisting the engagement team to plan and perform the audit.
    - Assisting members of the engagement team responsible for supervision to direct and supervise the audit work, and to discharge their review responsibilities in accordance with HKSA 220.[2]
    - Enabling the engagement team to be accountable for its work.
    - Retaining a record of matters of continuing significance to future audits.
    - Enabling the conduct of quality control reviews and inspections in accordance with HKSQC 1[3] ~~or national requirements that are at least as demanding~~.[4]
    - Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

Effective Date

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

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1 HKSA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing," paragraph 11.

2 HKSA 220, "Quality Control for an Audit of Financial Statements," paragraphs 15-17.

3 HKSQC 1, "Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements," paragraphs 32-33, 35-38, and 48.

4 HKSA 220, paragraph 2.

Objective

5. The objective of the auditor is to prepare documentation that provides:

   (a) A sufficient and appropriate record of the basis for the auditor's report; and

   (b) Evidence that the audit was planned and performed in accordance with HKSAs and applicable legal and regulatory requirements.

Definitions

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

   (a) Audit documentation – The record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached (terms such as "working papers" or "workpapers" are also sometimes used).

   (b) Audit file – One or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific engagement.

   (c) Experienced auditor – An individual (whether internal or external to the firm) who has practical audit experience, and a reasonable understanding of:

      (i) Audit processes;

      (ii) HKSAs and applicable legal and regulatory requirements;

      (iii) The business environment in which the entity operates; and

      (iv) Auditing and financial reporting issues relevant to the entity's industry.

Requirements

Timely Preparation of Audit Documentation

7. The auditor shall prepare audit documentation on a timely basis. (Ref: Para. A1)

Documentation of the Audit Procedures Performed and Audit Evidence Obtained

Form, Content and Extent of Audit Documentation

8. The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand: (Ref: Para. A2-A5, A16-A17)

   (a) The nature, timing, and extent of the audit procedures performed to comply with the HKSAs and applicable legal and regulatory requirements; (Ref: Para. A6-A7)

   (b) The results of the audit procedures performed, and the audit evidence obtained; and

   (c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions. (Ref: Para. A8-A11)

9. In documenting the nature, timing and extent of audit procedures performed, the auditor shall record:

   (a) The identifying characteristics of the specific items or matters tested; (Ref: Para. A12)

   (b) Who performed the audit work and the date such work was completed; and

   (c) Who reviewed the audit work performed and the date and extent of such review. (Ref: Para. A13)

10. The auditor shall document discussions of significant matters with management, those charged with governance, and others, including the nature of the significant matters discussed and when and with whom the discussions took place. (Ref: Para. A14)

11. If the auditor identified information that is inconsistent with the auditor's final conclusion regarding a significant matter, the auditor shall document how the auditor addressed the inconsistency. (Ref: Para. A15)

Departure from a Relevant Requirement

12. If, in exceptional circumstances, the auditor judges it necessary to depart from a relevant requirement in an HKSA, the auditor shall document how the alternative audit procedures performed achieve the aim of that requirement, and the reasons for the departure. (Ref: Para. A18-A19)

Matters Arising after the Date of the Auditor's Report

13. If, in exceptional circumstances, the auditor performs new or additional audit procedures or draws new conclusions after the date of the auditor's report, the auditor shall document: (Ref: Para. A20)

   (a) The circumstances encountered;

   (b) The new or additional audit procedures performed, audit evidence obtained, and conclusions reached, and their effect on the auditor's report; and

   (c) When and by whom the resulting changes to audit documentation were made and reviewed.

Assembly of the Final Audit File

14. The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report. (Ref: Para. A21-A22)

15. After the assembly of the final audit file has been completed, the auditor shall not delete or discard audit documentation of any nature before the end of its retention period. (Ref: Para. A23)

16. In circumstances other than those envisaged in paragraph 13 where the auditor finds it necessary to modify existing audit documentation or add new audit documentation after the assembly of the final audit file has been completed, the auditor shall, regardless of the nature of the modifications or additions, document: (Ref: Para. A24)

   (a) The specific reasons for making them; and

   (b) When and by whom they were made and reviewed.

Conformity and Compliance with International Standards on Auditing

17. As of June 2009 (date of issue), this HKSA conforms with International Standard on Auditing (ISA) 230, "Audit Documentation". Compliance with the requirements of this HKSA ensures compliance with ISA 230.

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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 HKSAs (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 HKSAs contain specific documentation requirements that are intended to clarify the application of this HKSA in the particular circumstances of those other HKSAs. The specific documentation requirements of other HKSAs 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 HKSAs. 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 HKSAs.
- 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 HKSAs. Such evidence may include specific procedures performed to corroborate management's responses to the auditor's inquiries.

- ○ Similarly, that the engagement partner has taken responsibility for the direction, supervision and performance of the audit in compliance with the HKSAs 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 (for example, the reasonableness of significant accounting estimates).
- 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.

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[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*

A11. The auditor may consider it helpful to prepare and retain as part of the audit documentation a summary (sometimes known as a completion memorandum) that describes the significant matters identified during the audit and how they were addressed, or that includes cross-references to other relevant supporting audit documentation that provides such information. Such a summary may facilitate effective and efficient reviews and inspections of the audit documentation, particularly for large and complex audits. Further, the preparation of such a summary may assist the auditor's consideration of the significant matters. It may also help the auditor to consider whether, in light of the audit procedures performed and conclusions reached, there is any individual relevant HKSA objective that the auditor cannot achieve that would prevent the auditor from achieving the overall objectives of the auditor.

Identification of Specific Items or Matters Tested, and of the Preparer and Reviewer (Ref: Para. 9)

A12. Recording the identifying characteristics serves a number of purposes. For example, it enables the engagement team to be accountable for its work and facilitates the investigation of exceptions or inconsistencies. Identifying characteristics will vary with the nature of the audit procedure and the item or matter tested. For example:

- For a detailed test of entity-generated purchase orders, the auditor may identify the documents selected for testing by their dates and unique purchase order numbers.
- For a procedure requiring selection or review of all items over a specific amount from a given population, the auditor may record the scope of the procedure and identify the population (for example, all journal entries over a specified amount from the journal register).
- For a procedure requiring systematic sampling from a population of documents, the auditor may identify the documents selected by recording their source, the starting point and the sampling interval (for example, a systematic sample of shipping reports selected from the shipping log for the period from April 1 to September 30, starting with report number 12345 and selecting every 125th report).
- For a procedure requiring inquiries of specific entity personnel, the auditor may record the dates of the inquiries and the names and job designations of the entity personnel.
- For an observation procedure, the auditor may record the process or matter being observed, the relevant individuals, their respective responsibilities, and where and when the observation was carried out.

A13. HKSA 220 requires the auditor to review the audit work performed through review of the audit documentation.[8] The requirement to document who reviewed the audit work performed does not imply a need for each specific working paper to include evidence of review. The requirement, however, means documenting what audit work was reviewed, who reviewed such work, and when it was reviewed.

Documentation of Discussions of Significant Matters with Management, Those Charged with Governance, and Others (Ref: Para. 10)

A14. The documentation is not limited to records prepared by the auditor but may include other appropriate records such as minutes of meetings prepared by the entity's personnel and agreed by the auditor. Others with whom the auditor may discuss significant matters may include other personnel within the entity, and external parties, such as persons providing professional advice to the entity.

[8] HKSA 220, paragraph 17.

Documentation of How Inconsistencies Have Been Addressed (Ref: Para. 11)

A15. The requirement to document how the auditor addressed inconsistencies in information does not imply that the auditor needs to retain documentation that is incorrect or superseded.

Considerations Specific to Smaller Entities (Ref. Para. 8)

A16. The audit documentation for the audit of a smaller entity is generally less extensive than that for the audit of a larger entity. Further, in the case of an audit where the engagement partner performs all the audit work, the documentation will not include matters that might have to be documented solely to inform or instruct members of an engagement team, or to provide evidence of review by other members of the team (for example, there will be no matters to document relating to team discussions or supervision). Nevertheless, the engagement partner complies with the overriding requirement in paragraph 8 to prepare audit documentation that can be understood by an experienced auditor, as the audit documentation may be subject to review by external parties for regulatory or other purposes.

A17. When preparing audit documentation, the auditor of a smaller entity may also find it helpful and efficient to record various aspects of the audit together in a single document, with cross-references to supporting working papers as appropriate. Examples of matters that may be documented together in the audit of a smaller entity include the understanding of the entity and its internal control, the overall audit strategy and audit plan, materiality determined in accordance with HKSA 320, [9] assessed risks, significant matters noted during the audit, and conclusions reached.

Departure from a Relevant Requirement (Ref: Para. 12)

A18. 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. Accordingly, other than in exceptional circumstances, the HKSAs call for compliance with each requirement that is relevant in the circumstances of the audit.

A19. The documentation requirement applies only to requirements that are relevant in the circumstances. A requirement is not relevant[10] only in the cases where:

(a) The entire HKSA is not relevant (for example, if an entity does not have an internal audit function , nothing in HKSA 610 (Revised 2013)[11] is relevant); or

(b) The requirement is conditional and the condition does not exist (for example, the requirement to modify the auditor's opinion where there is an inability to obtain sufficient appropriate audit evidence, and there is no such inability).

Matters Arising after the Date of the Auditor's Report (Ref: Para. 13)

A20. Examples of exceptional circumstances include facts which become known to the auditor after the date of the auditor's report but which existed at that date and which, if known at that date, might have caused the financial statements to be amended or the auditor to modify the opinion in the auditor's report.[12] The resulting changes to the audit documentation are reviewed in accordance with the review responsibilities set out in HKSA 220,[13] with the engagement partner taking final responsibility for the changes.

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[9] HKSA 320, "Materiality in Planning and Performing an Audit."

[10] HKSA 200, paragraph 22.

[11] HKSA 610 (Revised 2013), "Using the Work of Internal Auditors", paragraph 2.

[12] HKSA 560, "Subsequent Events," paragraph 14.

[13] HKSA 220, paragraph 16.

Assembly of the Final Audit File (Ref: Para. 14-16)

A21. HKSQC 1 ~~(or national requirements that are at least as demanding)~~ requires firms to establish policies and procedures for the timely completion of the assembly of audit files.[14] An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report.[15]

A22. The completion of the assembly of the final audit file after the date of the auditor's report is an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions. Changes may, however, be made to the audit documentation during the final assembly process if they are administrative in nature. Examples of such changes include:

- Deleting or discarding superseded documentation.
- Sorting, collating and cross-referencing working papers.
- Signing off on completion checklists relating to the file assembly process.
- Documenting audit evidence that the auditor has obtained, discussed and agreed with the relevant members of the engagement team before the date of the auditor's report.

A23. HKSQC 1 ~~(or national requirements that are at least as demanding)~~ requires firms to establish policies and procedures for the retention of engagement documentation.[16] The retention period for audit engagements ordinarily is no shorter than five years from the date of the auditor's report, or, if later, the date of the group auditor's report.[17]

A24. An example of a circumstance in which the auditor may find it necessary to modify existing audit documentation or add new audit documentation after file assembly has been completed is the need to clarify existing audit documentation arising from comments received during monitoring inspections performed by internal or external parties.

[14] HKSQC 1, paragraph 45.
[15] HKSQC 1, paragraph A54.
[16] HKSQC 1, paragraph 47.
[17] HKSQC 1, paragraph A61.

Appendix

(Ref: Para. 1)

Specific Audit Documentation Requirements in Other HKSAs

This appendix identifies paragraphs in other HKSAs ~~in effect for audits of financial statements for periods beginning on or after 15 December 2009~~ 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
- HKSA 260, *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, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures* – paragraph 23
- 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

HKSA 260 (Revised)
Issued August 2015

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

Hong Kong Standard on Auditing 260 (Revised)

Communication with those Charged with Governance

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

HONG KONG STANDARD ON AUDITING 260 (REVISED)
COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE

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

CONTENTS

Hong Kong Standard on Auditing (HKSA) 260 (Revised), *Communication with Those Charged with Governance,* should be read in conjunction with HKSA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing*.

Introduction

Scope of this HKSA

1. This Hong Kong Standard on Auditing (HKSA) deals with the auditor's responsibility to communicate with those charged with governance in an audit of financial statements. Although this HKSA applies irrespective of an entity's governance structure or size, particular considerations apply where all of those charged with governance are involved in managing an entity, and for listed entities. This HKSA does not establish requirements regarding the auditor's communication with an entity's management or owners unless they are also charged with a governance role.

2. This HKSA is written in the context of an audit of financial statements, but may also be applicable, adapted as necessary in the circumstances, to audits of other historical financial information when those charged with governance have a responsibility to oversee the preparation of the other historical financial information.

3. Recognizing the importance of effective two-way communication in an audit of financial statements, this HKSA provides an overarching framework for the auditor's communication with those charged with governance, and identifies some specific matters to be communicated with them. Additional matters to be communicated, which complement the requirements of this HKSA, are identified in other HKSAs (see Appendix 1). In addition, HKSA 265[1] establishes specific requirements regarding the communication of significant deficiencies in internal control the auditor has identified during the audit to those charged with governance. Further matters, not required by this or other HKSAs, may be required to be communicated by law or regulation, by agreement with the entity, or by additional requirements applicable to the engagement, for example, the standards of a professional accountancy body. Nothing in this HKSA precludes the auditor from communicating any other matters to those charged with governance. (Ref: Para. A33–A36)

The Role of Communication

4. This HKSA focuses primarily on communications from the auditor to those charged with governance. Nevertheless, effective two-way communication is important in assisting:

   (a) The auditor and those charged with governance in understanding matters related to the audit in context, and in developing a constructive working relationship. This relationship is developed while maintaining the auditor's independence and objectivity;

   (b) The auditor in obtaining from those charged with governance information relevant to the audit. For example, those charged with governance may assist the auditor in understanding the entity and its environment, in identifying appropriate sources of audit evidence, and in providing information about specific transactions or events; and

   (c) Those charged with governance in fulfilling their responsibility to oversee the financial reporting process, thereby reducing the risks of material misstatement of the financial statements.

5. Although the auditor is responsible for communicating matters required by this HKSA, management also has a responsibility to communicate matters of governance interest to those charged with governance. Communication by the auditor does not relieve management of this responsibility. Similarly, communication by management with those charged with governance of

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[1] HKSA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*

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

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

7. Law or regulation may restrict the auditor's communication of certain matters with those charged with governance. For example, laws or regulations may specifically prohibit a communication[1a], or other action, that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act. In some circumstances, potential conflicts between the auditor's obligations of confidentiality and obligations to communicate may be complex. In such cases, the auditor may consider obtaining legal advice.

Effective Date

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

Objectives

9. The objectives of the auditor are:

   (a) To communicate clearly with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, and an overview of the planned scope and timing of the audit;

   (b) To obtain from those charged with governance information relevant to the audit;

   (c) To provide those charged with governance with timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process; and

   (d) To promote effective two-way communication between the auditor and those charged with governance.

Definitions

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

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

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

(b) Management – The person(s) with executive responsibility for the conduct of the entity's operations. For some entities in some jurisdictions, management includes some or all of those charged with governance, for example, executive members of a governance board, or an owner-manager.

Requirements

Those Charged with Governance

11. The auditor shall determine the appropriate person(s) within the entity's governance structure with whom to communicate. (Ref: Para. A1–A4)

Communication with a Subgroup of Those Charged with Governance

12. If the auditor communicates with a subgroup of those charged with governance, for example, an audit committee, or an individual, the auditor shall determine whether the auditor also needs to communicate with the governing body. (Ref: Para. A5–A7)

When All of Those Charged with Governance Are Involved in Managing the Entity

13. In some cases, all of those charged with governance are involved in managing the entity, for example, a small business where a single owner manages the entity and no one else has a governance role. In these cases, if matters required by this HKSA are communicated with person(s) with management responsibilities, and those person(s) also have governance responsibilities, the matters need not be communicated again with those same person(s) in their governance role. These matters are noted in paragraph 16(c). The auditor shall nonetheless be satisfied that communication with person(s) with management responsibilities adequately informs all of those with whom the auditor would otherwise communicate in their governance capacity. (Ref: Para. A8)

Matters to Be Communicated

The Auditor's Responsibilities in Relation to the Financial Statement Audit

14. The auditor shall communicate with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, including that:

    (a) The auditor is responsible for forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance; and

    (b) The audit of the financial statements does not relieve management or those charged with governance of their responsibilities. (Ref: Para. A9–A10)

Planned Scope and Timing of the Audit

15. The auditor shall communicate with those charged with governance an overview of the planned scope and timing of the audit, which includes communicating about the significant risks identified by the auditor. (Ref: Para. A11–A16)

Significant Findings from the Audit

16. The auditor shall communicate with those charged with governance: (Ref: Para. A17–A18)

    (a) The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures. When applicable, the auditor shall explain to those charged with governance why the auditor considers a significant accounting practice, that is acceptable under the applicable financial reporting framework, not to be most appropriate to the particular circumstances of the entity; (Ref: Para. A19–A20)

    (b) Significant difficulties, if any, encountered during the audit; (Ref: Para. A21)

    (c) Unless all of those charged with governance are involved in managing the entity:

        (i) Significant matters arising during the audit that were discussed, or subject to correspondence, with management; and (Ref: Para. A22)

        (ii) Written representations the auditor is requesting;

    (d) Circumstances that affect the form and content of the auditor's report, if any; and (Ref: Para. A23–A25)

    (e) Any other significant matters arising during the audit that, in the auditor's professional judgment, are relevant to the oversight of the financial reporting process. (Ref: Para. A26–A28)

Auditor Independence

17. In the case of listed entities, the auditor shall communicate with those charged with governance:

    (a) A statement that the engagement team and others in the firm as appropriate, the firm and, when applicable, network firms have complied with relevant ethical requirements regarding independence; and

        (i) All relationships and other matters between the firm, network firms, and the entity that, in the auditor's professional judgment, may reasonably be thought to bear on independence. This shall include total fees charged during the period covered by the financial statements for audit and non-audit services provided by the firm and network firms to the entity and components controlled by the entity. These fees shall be allocated to categories that are appropriate to assist those charged with governance in assessing the effect of services on the independence of the auditor; and

        (ii) The related safeguards that have been applied to eliminate identified threats to independence or reduce them to an acceptable level. (Ref: Para. A29–A32)

The Communication Process

Establishing the Communication Process

18. The auditor shall communicate with those charged with governance the form, timing and expected general content of communications. (Ref: Para. A37–A45)

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

25. Additional local guidance is provided in footnote 1a.

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Application and Other Explanatory Material

Those Charged with Governance (Ref: Para. 11)

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

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

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

- In some cases, some or all of those charged with governance are involved in managing the entity. In others, those charged with governance and management comprise different persons.
- In some cases, those charged with governance are responsible for approving[3] the entity's financial statements (in other cases management has this responsibility).

A2. In most entities, governance is the collective responsibility of a governing body, such as a board of directors, a supervisory board, partners, proprietors, a committee of management, a council of governors, trustees, or equivalent persons. In some smaller entities, however, one person may be charged with governance, for example, the owner-manager where there are no other owners, or a sole trustee. When governance is a collective responsibility, a subgroup such as an audit committee or even an individual, may be charged with specific tasks to assist the governing body in meeting its responsibilities. Alternatively, a subgroup or individual may have specific, legally identified responsibilities that differ from those of the governing body.

A3. Such diversity means that it is not possible for this HKSA to specify for all audits the person(s) with whom the auditor is to communicate particular matters. Also, in some cases, the appropriate person(s) with whom to communicate may not be clearly identifiable from the applicable legal framework or other engagement circumstances, for example, entities where the governance structure is not formally defined, such as some family-owned entities, some not-for-profit organizations, and some government entities. In such cases, the auditor may need to discuss and agree with the engaging party the relevant person(s) with whom to communicate. In deciding with whom to communicate, the auditor's understanding of an entity's governance structure and processes obtained in accordance with HKSA 315 (Revised)[4] is relevant. The appropriate person(s) with whom to communicate may vary depending on the matter to be communicated.

A4. HKSA 600 includes specific matters to be communicated by group auditors with those charged with governance.[5] When the entity is a component of a group, the appropriate person(s) with whom the component auditor communicates depends on the engagement circumstances and the matter to be communicated. In some cases, a number of components may be conducting the same businesses within the same system of internal control and using the same accounting practices. Where those charged with governance of those components are the same (e.g., common board of directors), duplication may be avoided by dealing with these components concurrently for the purpose of communication.

Communication with a Subgroup of Those Charged with Governance (Ref: Para. 12)

A5. When considering communicating with a subgroup of those charged with governance, the auditor may take into account such matters as:

- The respective responsibilities of the subgroup and the governing body.
- The nature of the matter to be communicated.

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3 As described in paragraph A63 of HKSA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, having responsibility for approving in this context means having the authority to conclude that all the statements that comprise the financial statements, including the related notes, have been prepared.

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

5 HKSA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, paragraph 49

- Relevant legal or regulatory requirements.
- Whether the subgroup has the authority to take action in relation to the information communicated, and can provide further information and explanations the auditor may need.

A6. When deciding whether there is also a need to communicate information, in full or in summary form, with the governing body, the auditor may be influenced by the auditor's assessment of how effectively and appropriately the subgroup communicates relevant information with the governing body. The auditor may make explicit in agreeing the terms of engagement that, unless prohibited by law or regulation, the auditor retains the right to communicate directly with the governing body.

A7. Audit committees (or similar subgroups with different names) exist in many jurisdictions. Although their specific authority and functions may differ, communication with the audit committee, where one exists, has become a key element in the auditor's communication with those charged with governance. Good governance principles suggest that:

- The auditor will be invited to regularly attend meetings of the audit committee.
- The chair of the audit committee and, when relevant, the other members of the audit committee, will liaise with the auditor periodically.
- The audit committee will meet the auditor without management present at least annually.

When All of Those Charged with Governance Are Involved in Managing the Entity (Ref: Para.13)

A8. In some cases, all of those charged with governance are involved in managing the entity, and the application of communication requirements is modified to recognize this position. In such cases, communication with person(s) with management responsibilities may not adequately inform all of those with whom the auditor would otherwise communicate in their governance capacity. For example, in a company where all directors are involved in managing the entity, some of those directors (e.g., one responsible for marketing) may be unaware of significant matters discussed with another director (e.g., one responsible for the preparation of the financial statements).

Matters to Be Communicated

The Auditor's Responsibilities in Relation to the Financial Statement Audit (Ref: Para. 14)

A9. The auditor's responsibilities in relation to the financial statement audit are often included in the engagement letter or other suitable form of written agreement that records the agreed terms of the engagement.[6] Law, regulation or the governance structure of the entity may require those charged with governance to agree the terms of the engagement with the auditor. When this is not the case, providing those charged with governance with a copy of that engagement letter or other suitable form of written agreement may be an appropriate way to communicate with them regarding such matters as:

- The auditor's responsibility for performing the audit in accordance with HKSAs, which is directed towards the expression of an opinion on the financial statements. The matters that HKSAs require to be communicated, therefore, include significant matters arising during the audit of the financial statements that are relevant to those charged with governance in overseeing the financial reporting process.

[6] See paragraph 10 of HKSA 210, *Agreeing the Terms of Audit Engagements*.

- The fact that HKSAs do not require the auditor to design procedures for the purpose of identifying supplementary matters to communicate with those charged with governance.
- When HKSA 701[7] applies, the auditor's responsibilities to determine and communicate key audit matters in the auditor's report.
- When applicable, the auditor's responsibility for communicating particular matters required by law or regulation, by agreement with the entity or by additional requirements applicable to the engagement.

A10. Law or regulation, an agreement with the entity or additional requirements applicable to the engagement may provide for broader communication with those charged with governance. For example, (a) an agreement with the entity may provide for particular matters to be communicated when they arise from services provided by a firm or network firm other than the financial statement audit; or (b) the mandate of a public sector auditor may provide for matters to be communicated that come to the auditor's attention as a result of other work, such as performance audits.

Planned Scope and Timing of the Audit (Ref: Para. 15)

A11. Communication regarding the planned scope and timing of the audit may:

(a) Assist those charged with governance to understand better the consequences of the auditor's work, to discuss issues of risk and the concept of materiality with the auditor, and to identify any areas in which they may request the auditor to undertake additional procedures; and

(b) Assist the auditor to understand better the entity and its environment.

A12. Communicating significant risks identified by the auditor helps those charged with governance understand those matters and why they require special audit consideration. The communication about significant risks may assist those charged with governance in fulfilling their responsibility to oversee the financial reporting process.

A13. Matters communicated may include:

- How the auditor plans to address the significant risks of material misstatement, whether due to fraud or error.
- How the auditor plans to address areas of higher assessed risks of material misstatement.
- The auditor's approach to internal control relevant to the audit.
- The application of the concept of materiality in the context of an audit.[8]
- The nature and extent of specialized skill or knowledge needed to perform the planned audit procedures or evaluate the audit results, including the use of an auditor's expert.[9]
- When HKSA 701 applies, the auditor's preliminary views about matters that may be areas of significant auditor attention in the audit and therefore may be key audit matters.

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

[8] HKSA 320, *Materiality in Planning and Performing an Audit*

[9] See HKSA 620, *Using the Work of an Auditor's Expert*.

A14. Other planning matters that it may be appropriate to discuss with those charged with governance include:

- Where the entity has an internal audit function, how the external auditor and internal auditors can work together in a constructive and complementary manner, including any planned use of the work of the internal audit function, and the nature and extent of any planned use of internal auditors to provide direct assistance.[10]
- The views of those charged with governance of:
  - The appropriate person(s) in the entity's governance structure with whom to communicate.
  - The allocation of responsibilities between those charged with governance and management.
  - The entity's objectives and strategies, and the related business risks that may result in material misstatements.
  - Matters those charged with governance consider warrant particular attention during the audit, and any areas where they request additional procedures to be undertaken.
  - Significant communications with regulators.
  - Other matters those charged with governance consider may influence the audit of the financial statements.
- The attitudes, awareness, and actions of those charged with governance concerning (a) the entity's internal control and its importance in the entity, including how those charged with governance oversee the effectiveness of internal control, and (b) the detection or possibility of fraud.
- The actions of those charged with governance in response to developments in accounting standards, corporate governance practices , exchange listing rules, and related matters.
- The responses of those charged with governance to previous communications with the auditor.
- 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.

[10] HKSA 610 (Revised), *Using the Work of Internal Auditors*, paragraph 18, and HKSA 610 (Revised 2013), *Using the Work of Internal Auditors*, paragraph 31

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 key assumptions in the development of accounting estimates for which there is significant measurement uncertainty. 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 evaluation of the adequacy of disclosures of the estimation uncertainty relating to accounting estimates that give rise to significant risks. 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. Appendix 2 identifies matters that may be included in this communication.

Significant Difficulties Encountered during the Audit (Ref: Para. 16(b))

A21. Significant difficulties encountered during the audit may include such matters as:

- Significant delays by management, the unavailability of entity personnel, or an unwillingness by management to provide information necessary for the auditor to perform the auditor's procedures.
- An unreasonably brief time within which to complete the audit.
- Extensive unexpected effort required to obtain sufficient appropriate audit evidence.
- The unavailability of expected information.

[11] HKSA 701, paragraphs 9–10

- Restrictions imposed on the auditor by management.
- Management's unwillingness to make or extend its assessment of the entity's ability to continue as a going concern when requested.

In some circumstances, such difficulties may constitute a scope limitation that leads to a modification of the auditor's opinion.[12]

Significant Matters Discussed, or Subject to Correspondence with Management (Ref: Para. 16(c)(i))

A22. Significant matters discussed, or subject to correspondence with management may include such matters as:

- Significant events or transactions that occurred during the year.
- Business conditions affecting the entity, and business plans and strategies that may affect the risks of material misstatement.
- Concerns about management's consultations with other accountants on accounting or auditing matters.
- Discussions or correspondence in connection with the initial or recurring appointment of the auditor regarding accounting practices, the application of auditing standards, or fees for audit or other services.
- Significant matters on which there was disagreement with management, except for initial differences of opinion because of incomplete facts or preliminary information that are later resolved by the auditor obtaining additional relevant facts or information.

Circumstances that Affect the Form and Content of the Auditor's Report (Ref: Para 16(d))

A23. HKSA 210 requires the auditor to agree the terms of the audit engagement with management or those charged with governance, as appropriate.[13] The agreed terms of the audit engagement are required to be recorded in an audit engagement letter or other suitable form of written agreement and include, among other things, reference to the expected form and content of the auditor's report.[14] As explained in paragraph A9, if the terms of engagement are not agreed with those charged with governance, the auditor may provide those charged with governance with a copy of the engagement letter to communicate about matters relevant to the audit. The communication required by paragraph 16(d) is intended to inform those charged with governance about circumstances in which the auditor's report may differ from its expected form and content or may include additional information about the audit that was performed.

A24. Circumstances in which the auditor is required or may otherwise consider it necessary to include additional information in the auditor's report in accordance with the HKSAs, and for which communication with those charged with governance is required, include when:

- The auditor expects to modify the opinion in the auditor's report in accordance with HKSA 705 (Revised).[15]

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

13 HKSA 210, paragraph 9

14 HKSA 210, paragraph 10

15 HKSA 705 (Revised), paragraph 30

- A material uncertainty related to going concern is reported in accordance with HKSA 570 (Revised).[16]
- Key audit matters are communicated in accordance with HKSA 701.[17]
- The auditor considers it necessary to include an Emphasis of Matter paragraph or Other Matters paragraph in accordance with HKSA 706 (Revised)[18] or is required to do so by other HKSAs.
- The auditor has concluded that there is an uncorrected material misstatement of the other information in accordance with HKSA 720 (Revised).[19]

In such circumstances, the auditor may consider it useful to provide those charged with governance with a draft of the auditor's report to facilitate a discussion of how such matters will be addressed in the auditor's report.

A25. In the rare circumstances that the auditor intends not to include the name of the engagement partner in the auditor's report in accordance with HKSA 700 (Revised), the auditor is required to discuss this intention with those charged with governance to inform the auditor's assessment of the likelihood and severity of a significant personal security threat.[20] The auditor also may communicate with those charged with governance in circumstances when the auditor elects not to include the description of the auditor's responsibilities in the body of the auditor's report as permitted by HKSA 700 (Revised).[21]

Other Significant Matters Relevant to the Financial Reporting Process (Ref: Para. 16(e))

A26. HKSA 300[22] notes that, as a result of unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy and audit plan and thereby the resulting planned nature, timing and extent of further audit procedures, based on the revised consideration of assessed risks. The auditor may communicate with those charged with governance about such matters, for example, as an update to initial discussions about the planned scope and timing of the audit.

A27. Other significant matters arising during the audit that are directly relevant to those charged with governance in overseeing the financial reporting process may include such matters as material misstatements of the other information that have been corrected.

A28. To the extent not already addressed by the requirements in paragraphs 16(a)–(d) and related application material, the auditor may consider communicating about other matters discussed with, or considered by, the engagement quality control reviewer, if one has been appointed, in accordance with HKSA 220.[23]

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16 HKSA 570 (Revised), *Going Concern*, paragraph 25(d)

17 HKSA 701, paragraph 17

18 HKSA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*, paragraph 12

19 HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*, paragraph 18(a)

20 HKSA 700 (Revised), paragraphs 45 and A58

21 HKSA 700 (Revised), paragraph 40

22 HKSA 300, *Planning an Audit of Financial Statements*, paragraph A13

23 See paragraphs 19–22 and A23–A31 of HKSA 220, *Quality Control for an Audit of Financial Statements*.

Auditor Independence (Ref: Para. 17)

A29. The auditor is required to comply with relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements.[24]

A30. The relationships and other matters, and safeguards to be communicated, vary with the circumstances of the engagement, but generally address:

(a) Threats to independence, which may be categorized as: self-interest threats, self-review threats, advocacy threats, familiarity threats, and intimidation threats; and

(b) Safeguards created by the profession, legislation or regulation, safeguards within the entity, and safeguards within the firm's own systems and procedures.

A31. Relevant ethical requirements or law or regulation may also specify particular communications to those charged with governance in circumstances where breaches of independence requirements have been identified. For example, the HKICPA's *Code of Ethics for Professional Accountants* (the Code) requires the auditor to communicate with those charged with governance in writing about any breach and the action the firm has taken or proposes to take.[25]

A32. The communication requirements relating to auditor independence that apply in the case of listed entities may also be appropriate in the case of some other entities, including those that may be of significant public interest, for example because they have a large number and wide range of stakeholders and considering the nature and size of the business. Examples of such entities may include financial institutions (such as banks, insurance companies, and pension funds), and other entities such as charities. On the other hand, there may be situations where communications regarding independence may not be relevant, for example, where all of those charged with governance have been informed of relevant facts through their management activities. This is particularly likely where the entity is owner-managed, and the auditor's firm and network firms have little involvement with the entity beyond a financial statement audit.

Supplementary Matters (Ref: Para. 3)

A33. The oversight of management by those charged with governance includes ensuring that the entity designs, implements and maintains appropriate internal control with regard to reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.

A34. The auditor may become aware of supplementary matters that do not necessarily relate to the oversight of the financial reporting process but which are, nevertheless, likely to be significant to the responsibilities of those charged with governance in overseeing the strategic direction of the entity or the entity's obligations related to accountability. Such matters may include, for example, significant issues regarding governance structures or processes, and significant decisions or actions by senior management that lack appropriate authorization.

A35. In determining whether to communicate supplementary matters with those charged with governance, the auditor may discuss matters of this kind of which the auditor has become aware with the appropriate level of management, unless it is inappropriate to do so in the circumstances.

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[24] HKSA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing*, paragraph 14

[25] See Section 290.39–49 of the Code, which addresses breaches of independence.

A36. If a supplementary matter is communicated, it may be appropriate for the auditor to make those charged with governance aware that:

(a) Identification and communication of such matters is incidental to the purpose of the audit, which is to form an opinion on the financial statements;

(b) No procedures were carried out with respect to the matter other than any that were necessary to form an opinion on the financial statements; and

(c) No procedures were carried out to determine whether other such matters exist.

The Communication Process

Establishing the Communication Process (Ref: Para. 18)

A37. Clear communication of the auditor's responsibilities, the planned scope and timing of the audit, and the expected general content of communications helps establish the basis for effective two-way communication.

A38. Matters that may also contribute to effective two-way communication include discussion of:

- The purpose of communications. When the purpose is clear, the auditor and those charged with governance are better placed to have a mutual understanding of relevant issues and the expected actions arising from the communication process.
- The form in which communications will be made.
- The person(s) in the engagement team and among those charged with governance who will communicate regarding particular matters.
- The auditor's expectation that communication will be two-way, and that those charged with governance will communicate with the auditor matters they consider relevant to the audit, for example, strategic decisions that may significantly affect the nature, timing and extent of audit procedures, the suspicion or the detection of fraud, and concerns with the integrity or competence of senior management.
- The process for taking action and reporting back on matters communicated by the auditor.
- The process for taking action and reporting back on matters communicated by those charged with governance.

A39. The communication process will vary with the circumstances, including the size and governance structure of the entity, how those charged with governance operate, and the auditor's view of the significance of matters to be communicated. Difficulty in establishing effective two-way communication may indicate that the communication between the auditor and those charged with governance is not adequate for the purpose of the audit (see paragraph A52).

Considerations Specific to Smaller Entities

A40. In the case of audits of smaller entities, the auditor may communicate in a less structured manner with those charged with governance than in the case of listed or larger entities.

Communication with Management

A41. Many matters may be discussed with management in the ordinary course of an audit, including matters required by this HKSA to be communicated with those charged with governance. Such discussions recognize management's executive responsibility for the conduct of the entity's operations and, in particular, management's responsibility for the preparation of the financial statements.

A42. Before communicating matters with those charged with governance, the auditor may discuss them with management, unless that is inappropriate. For example, it may not be appropriate to discuss questions of management's competence or integrity with management. In addition to recognizing management's executive responsibility, these initial discussions may clarify facts and issues, and give management an opportunity to provide further information and explanations. Similarly, when the entity has an internal audit function, the auditor may discuss matters with the internal auditor before communicating with those charged with governance.

Communication with Third Parties

A43. Those charged with governance may be required by law or regulation, or may wish, to provide third parties, for example, bankers or certain regulatory authorities, with copies of a written communication from the auditor. In some cases, disclosure to third parties may be illegal or otherwise inappropriate. When a written communication prepared for those charged with governance is provided to third parties, it may be important in the circumstances that the third parties be informed that the communication was not prepared with them in mind, for example, by stating in written communications with those charged with governance:

(a) That the communication has been prepared for the sole use of those charged with governance and, where applicable, the group management and the group auditor, and should not be relied upon by third parties;

(b) That no responsibility is assumed by the auditor to third parties; and

(c) Any restrictions on disclosure or distribution to third parties.

A44. In some jurisdictions the auditor may be required by law or regulation to, for example:

- Notify a regulatory or enforcement body of certain matters communicated with those charged with governance. For example, in some countries the auditor has a duty to report misstatements to authorities where management and those charged with governance fail to take corrective action;
- Submit copies of certain reports prepared for those charged with governance to relevant regulatory or funding bodies, or other bodies such as a central authority in the case of some public sector entities; or
- Make reports prepared for those charged with governance publicly available.

A45. Unless required by law or regulation to provide a third party with a copy of the auditor's written communications with those charged with governance, the auditor may need the prior consent of those charged with governance before doing so.

Forms of Communication (Ref: Para. 19)

A46. Effective communication may involve structured presentations and written reports as well as less structured communications, including discussions. The auditor may communicate matters other than those identified in paragraphs 19–20 either orally or in writing. Written communications may include an engagement letter that is provided to those charged with governance.

A47. In addition to the significance of a particular matter, the form of communication (e.g., whether to communicate orally or in writing, the extent of detail or summarization in the communication, and whether to communicate in a structured or unstructured manner) may be affected by such factors as:

- Whether a discussion of the matter will be included in the auditor's report. For example, when key audit matters are communicated in the auditor's report, the auditor may consider it necessary to communicate in writing about the matters determined to be key audit matters.
- Whether the matter has been satisfactorily resolved.
- Whether management has previously communicated the matter.
- The size, operating structure, control environment, and legal structure of the entity.
- In the case of an audit of special purpose financial statements, whether the auditor also audits the entity's general purpose financial statements.
- Legal requirements. In some jurisdictions, a written communication with those charged with governance is required in a prescribed form by local law.
- The expectations of those charged with governance, including arrangements made for periodic meetings or communications with the auditor.
- The amount of ongoing contact and dialogue the auditor has with those charged with governance.
- Whether there have been significant changes in the membership of a governing body.

A48. When a significant matter is discussed with an individual member of those charged with governance, for example, the chair of an audit committee, it may be appropriate for the auditor to summarize the matter in later communications so that all of those charged with governance have full and balanced information.

Timing of Communications (Ref: Para. 21)

A49. Timely communication throughout the audit contributes to the achievement of robust two-way dialogue between those charged with governance and the auditor. However, the appropriate timing for communications will vary with the circumstances of the engagement. Relevant circumstances include the significance and nature of the matter, and the action expected to be taken by those charged with governance. For example:

- Communications regarding planning matters may often be made early in the audit engagement and, for an initial engagement, may be made as part of agreeing the terms of the engagement.

- It may be appropriate to communicate a significant difficulty encountered during the audit as soon as practicable if those charged with governance are able to assist the auditor to overcome the difficulty, or if it is likely to lead to a modified opinion. Similarly, the auditor may communicate orally to those charged with governance as soon as practicable significant deficiencies in internal control that the auditor has identified, prior to communicating these in writing as required by HKSA 265.[26]

- When HKSA 701 applies, the auditor may communicate preliminary views about key audit matters when discussing the planned scope and timing of the audit (see paragraph A13), and the auditor also may have more frequent communications to further discuss such matters when communicating about significant audit findings.

- Communications regarding independence may be appropriate whenever significant judgments are made about threats to independence and related safeguards, for example, when accepting an engagement to provide non-audit services, and at a concluding discussion.

- Communications regarding findings from the audit, including the auditor's views about the qualitative aspects of the entity's accounting practices, may also be made as part of the concluding discussion.

- When auditing both general purpose and special purpose financial statements, it may be appropriate to coordinate the timing of communications.

A50. Other factors that may be relevant to the timing of communications include:

- The size, operating structure, control environment, and legal structure of the entity being audited.

- Any legal obligation to communicate certain matters within a specified timeframe.

- The expectations of those charged with governance, including arrangements made for periodic meetings or communications with the auditor.

- The time at which the auditor identifies certain matters, for example, the auditor may not identify a particular matter (e.g., noncompliance with a law) in time for preventive action to be taken, but communication of the matter may enable remedial action to be taken.

Adequacy of the Communication Process (Ref: Para. 22)

A51. The auditor need not design specific procedures to support the evaluation of the two-way communication between the auditor and those charged with governance; rather, that evaluation may be based on observations resulting from audit procedures performed for other purposes. Such observations may include:

- The appropriateness and timeliness of actions taken by those charged with governance in response to matters raised by the auditor. Where significant matters raised in previous communications have not been dealt with effectively, it may be appropriate for the auditor to inquire as to why appropriate action has not been taken, and to consider raising the point again. This avoids the risk of giving an impression that the auditor is satisfied that the matter has been adequately addressed or is no longer significant.

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[26] HKSA 265, paragraphs 9 and A14

- The apparent openness of those charged with governance in their communications with the auditor.
- The willingness and capacity of those charged with governance to meet with the auditor without management present.
- The apparent ability of those charged with governance to fully comprehend matters raised by the auditor, for example, the extent to which those charged with governance probe issues, and question recommendations made to them.
- Difficulty in establishing with those charged with governance a mutual understanding of the form, timing and expected general content of communications.
- Where all or some of those charged with governance are involved in managing the entity, their apparent awareness of how matters discussed with the auditor affect their broader governance responsibilities, as well as their management responsibilities.
- Whether the two-way communication between the auditor and those charged with governance meets applicable legal and regulatory requirements.

A52. As noted in paragraph 4, effective two-way communication assists both the auditor and those charged with governance. Further, HKSA 315 (Revised) identifies participation by those charged with governance, including their interaction with internal audit, if any, and external auditors, as an element of the entity's control environment.[27] Inadequate two-way communication may indicate an unsatisfactory control environment and influence the auditor's assessment of the risks of material misstatements. There is also a risk that the auditor may not have obtained sufficient appropriate audit evidence to form an opinion on the financial statements.

A53. If the two-way communication between the auditor and those charged with governance is not adequate and the situation cannot be resolved, the auditor may take such actions as:

- Modifying the auditor's opinion on the basis of a scope limitation.
- Obtaining legal advice about the consequences of different courses of action.
- Communicating with third parties (e.g., a regulator), or a higher authority in the governance structure that is outside the entity, such as the owners of a business (e.g., shareholders in a general meeting), or the responsible government minister or parliament in the public sector.
- Withdrawing from the engagement, where withdrawal is possible under applicable law or regulation.

Documentation (Ref: Para. 23)

A54. Documentation of oral communication may include a copy of minutes prepared by the entity retained as part of the audit documentation where those minutes are an appropriate record of the communication.

[27] HKSA 315 (Revised), paragraph A77

Appendix 1

(Ref: Para. 3)

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

This appendix identifies paragraphs in HKSQC 1[1] and other HKSAs 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 HKSAs.

- 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 21, 38(c)(i) and 40-42
- HKSA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements* – paragraphs 14, 19 and 22–24
- 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 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), *Using the Work of Internal Auditors* – paragraph 18; 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 45
- 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*

- HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information* – paragraphs 17–19.

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

- For items for which estimates are significant, issues discussed in HKSA 540,[1] including, for example:
  - How management identifies those transactions, events and conditions that may give rise to the need for accounting estimates to be recognized or disclosed in the financial statements.
  - Changes in circumstances that may give rise to new, or the need to revise existing, accounting estimates.
  - Whether management's decision to recognize, or to not recognize, the accounting estimates in the financial statements is in accordance with the applicable financial reporting framework.
  - Whether there has been or ought to have been a change from the prior period in the methods for making the accounting estimates and, if so, why, as well as the outcome of accounting estimates in prior periods.
  - Management's process for making accounting estimates (e.g., when management has used a model), including whether the selected measurement basis for the accounting estimate is in accordance with the applicable financial reporting framework.

[1] HKSA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*

  - Whether the significant assumptions used by management in developing the accounting estimate are reasonable.
  - Where relevant to the reasonableness of the significant assumptions used by management or the appropriate application of the applicable financial reporting framework, management's intent to carry out specific courses of action and its ability to do so.
  - Risks of material misstatement.
  - Indicators of possible management bias.
  - How management has considered alternative assumptions or outcomes and why it has rejected them, or how management has otherwise addressed estimation uncertainty in making the accounting estimate.
  - The adequacy of disclosure of estimation uncertainty in the financial statements.

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.
  - 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 450

Issued July 2009; revised July 2010, August 2015*

Effective for audits of financial statements

for periods beginning on or after 15 December 2009

Hong Kong Standard on Auditing 450

Evaluation of Misstatements Identified during the Audit

* Conforming amendments have been made to this HKSA as a result of the new and revised HKSAs issued in Update 172, and will become effective for audits of financial statements for periods ending on or after 15 December 2016. The conforming amendments are underlined for easy reference.

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

HONG KONG STANDARD ON AUDITING 450

EVALUATION OF MISSTATEMENTS IDENTIFIED DURING THE AUDIT

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

CONTENTS

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

Introduction

Scope of this HKSA

1. This Hong Kong Standard on Auditing (HKSA) deals with the auditor's responsibility to evaluate the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements. HKSA 700 deals with the auditor's responsibility, in forming an opinion on the financial statements, to conclude whether reasonable assurance has been obtained about whether the financial statements as a whole are free from material misstatement. The auditor's conclusion required by HKSA 700 takes into account the auditor's evaluation of uncorrected misstatements, if any, on the financial statements, in accordance with this HKSA.[1] HKSA 320[2] deals with the auditor's responsibility to apply the concept of materiality appropriately in planning and performing an audit of financial statements.

Effective Date

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

Objective

3. The objective of the auditor is to evaluate:

   (a) The effect of identified misstatements on the audit; and

   (b) The effect of uncorrected misstatements, if any, on the financial statements.

Definitions

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

   (a) Misstatement – A difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud. (Ref: Para. A1)

   When the auditor expresses an opinion on whether the financial statements are presented fairly, in all material respects, or give a true and fair view, misstatements also include those adjustments of amounts, classifications, presentation, or disclosures that, in the auditor's judgment, are necessary for the financial statements to be presented fairly, in all material respects, or to give a true and fair view.

   (b) Uncorrected misstatements – Misstatements that the auditor has accumulated during the audit and that have not been corrected.

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[1] HKSA 700, "Forming an Opinion and Reporting on Financial Statements," paragraphs 10-11.

[2] HKSA 320, "Materiality in Planning and Performing an Audit."

Requirements

Accumulation of Identified Misstatements

5. The auditor shall accumulate misstatements identified during the audit, other than those that are clearly trivial. (Ref: Para. A2-A3)

Consideration of Identified Misstatements as the Audit Progresses

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

   (a) The nature of identified misstatements and the circumstances of their occurrence indicate that other misstatements may exist that, when aggregated with misstatements accumulated during the audit, could be material; or (Ref: Para. A4)

   (b) The aggregate of misstatements accumulated during the audit approaches materiality determined in accordance with HKSA 320. (Ref: Para. A5)

7. If, at the auditor's request, management has examined a class of transactions, account balance or disclosure and corrected misstatements that were detected, the auditor shall perform additional audit procedures to determine whether misstatements remain. (Ref: Para. A6)

Communication and Correction of Misstatements

8. The auditor shall communicate on a timely basis all misstatements accumulated during the audit with the appropriate level of management, unless prohibited by law or regulation.[3] The auditor shall request management to correct those misstatements. (Ref: Para. A7-A9)

9. If management refuses to correct some or all of the misstatements communicated by the auditor, the auditor shall obtain an understanding of management's reasons for not making the corrections and shall take that understanding into account when evaluating whether the financial statements as a whole are free from material misstatement. (Ref: Para. A10)

Evaluating the Effect of Uncorrected Misstatements

10. Prior to evaluating the effect of uncorrected misstatements, the auditor shall reassess materiality determined in accordance with HKSA 320 to confirm whether it remains appropriate in the context of the entity's actual financial results. (Ref: Para. A11-A12)

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

    (a) The size and nature of the misstatements, both in relation to particular classes of transactions, account balances or disclosures and the financial statements as a whole, and the particular circumstances of their occurrence; and (Ref: Para. A13-A17, A19-A20)

    (b) The effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole. (Ref: Para. A18)

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[3] HKSA 260, "Communication with Those Charged with Governance," paragraph 7.

Communication with Those Charged with Governance

12. The auditor shall communicate with those charged with governance uncorrected misstatements and the effect that they, individually or in aggregate, may have on the opinion in the auditor's report, unless prohibited by law or regulation.[4] The auditor's communication shall identify material uncorrected misstatements individually. The auditor shall request that uncorrected misstatements be corrected. (Ref: Para. A21-A23)

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

Written Representations

14. The auditor shall request a written representation from management and, where appropriate, those charged with governance whether they believe the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole. A summary of such items shall be included in or attached to the written representation. (Ref: Para. A24)

Documentation

15. The auditor shall include in the audit documentation: [5] (Ref: Para. A25)

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

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

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

Conformity and Compliance with International Standards on Auditing

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

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Application and Other Explanatory Material

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

A1. Misstatements may result from:

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

    (b) An omission of an amount or disclosure;

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[4] See footnote 3.

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

(c) An incorrect accounting estimate arising from overlooking, or clear misinterpretation of, facts; and

(d) Judgments of management concerning accounting estimates that the auditor considers unreasonable or the selection and application of accounting policies that the auditor considers inappropriate.

Examples of misstatements arising from fraud are provided in HKSA 240.[6]

Accumulation of Identified Misstatements (Ref: Para. 5)

A2. The auditor may designate an amount below which misstatements would be clearly trivial and would not need to be accumulated because the auditor expects that the accumulation of such amounts clearly would not have a material effect on the financial statements. "Clearly trivial" is not another expression for "not material." Matters that are clearly trivial will be of a wholly different (smaller) order of magnitude than materiality determined in accordance with HKSA 320, and will be matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any criteria of size, nature or circumstances. When there is any uncertainty about whether one or more items are clearly trivial, the matter is considered not to be clearly trivial.

A3. To assist the auditor in evaluating the effect of misstatements accumulated during the audit and in communicating misstatements to management and those charged with governance, it may be useful to distinguish between factual misstatements, judgmental misstatements and projected misstatements.

- Factual misstatements are misstatements about which there is no doubt.

- Judgmental misstatements are differences arising from the judgments of management concerning accounting estimates that the auditor considers unreasonable, or the selection or application of accounting policies that the auditor considers inappropriate.

- Projected misstatements are the auditor's best estimate of misstatements in populations, involving the projection of misstatements identified in audit samples to the entire populations from which the samples were drawn. Guidance on the determination of projected misstatements and evaluation of the results is set out in HKSA 530.[7]

Consideration of Identified Misstatements as the Audit Progresses (Ref: Para. 6-7)

A4. A misstatement may not be an isolated occurrence. Evidence that other misstatements may exist include, for example, where the auditor identifies that a misstatement arose from a breakdown in internal control or from inappropriate assumptions or valuation methods that have been widely applied by the entity.

A5. If the aggregate of misstatements accumulated during the audit approaches materiality determined in accordance with HKSA 320, there may be a greater than acceptably low level of risk that possible undetected misstatements, when taken with the aggregate of misstatements accumulated during the audit, could exceed materiality. Undetected misstatements could exist because of the presence of sampling risk and non-sampling risk.[8]

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6 HKSA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements," paragraphs A1-A6.

7 HKSA 530, "Audit Sampling," paragraphs 14-15.

8 HKSA 530, paragraph 5(c)-(d).

A6. The auditor may request management to examine a class of transactions, account balance or disclosure in order for management to understand the cause of a misstatement identified by the auditor, perform procedures to determine the amount of the actual misstatement in the class of transactions, account balance or disclosure, and to make appropriate adjustments to the financial statements. Such a request may be made, for example, based on the auditor's projection of misstatements identified in an audit sample to the entire population from which it was drawn.

Communication and Correction of Misstatements (Ref: Para. 8-9)

A7. Timely communication of misstatements to the appropriate level of management is important as it enables management to evaluate whether the items are misstatements, inform the auditor if it disagrees, and take action as necessary. Ordinarily, the appropriate level of management is the one that has responsibility and authority to evaluate the misstatements and to take the necessary action.

A8. Law or regulation may restrict the auditor's communication of certain misstatements to management, or others, within the entity. For example, laws or regulations may specifically prohibit a communication, or other action, that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act. In some circumstances, potential conflicts between the auditor's obligations of confidentiality and obligations to communicate may be complex. In such cases, the auditor may consider seeking legal advice.

A9. The correction by management of all misstatements, including those communicated by the auditor, enables management to maintain accurate accounting books and records and reduces the risks of material misstatement of future financial statements because of the cumulative effect of immaterial uncorrected misstatements related to prior periods.

A10. HKSA 700 requires the auditor to evaluate whether the financial statements are prepared and presented, in all material respects, in accordance with the requirements of the applicable financial reporting framework. This evaluation includes consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments,[9] which may be affected by the auditor's understanding of management's reasons for not making the corrections.

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

A11. The auditor's determination of materiality in accordance with HKSA 320 is often based on estimates of the entity's financial results, because the actual financial results may not yet be known. Therefore, prior to the auditor's evaluation of the effect of uncorrected misstatements, it may be necessary to revise materiality determined in accordance with HKSA 320 based on the actual financial results.

A12. HKSA 320 explains that, as the audit progresses, materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) is revised in the event of the auditor becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially.[10] Thus, any significant revision is likely to have been made before the auditor evaluates the effect of uncorrected misstatements. However, if the auditor's reassessment of materiality determined in accordance with HKSA 320 (see paragraph 10 of this HKSA) gives rise to a lower amount (or amounts), then performance materiality and the appropriateness of the nature, timing and extent of the further audit procedures are

9 HKSA 700, paragraph 12.

10 HKSA 320, paragraph 12.

reconsidered so as to obtain sufficient appropriate audit evidence on which to base the audit opinion.

A13. Each individual misstatement is considered to evaluate its effect on the relevant classes of transactions, account balances or disclosures, including whether the materiality level for that particular class of transactions, account balance or disclosure, if any, has been exceeded.

A14. If an individual misstatement is judged to be material, it is unlikely that it can be offset by other misstatements. For example, if revenue has been materially overstated, the financial statements as a whole will be materially misstated, even if the effect of the misstatement on earnings is completely offset by an equivalent overstatement of expenses. It may be appropriate to offset misstatements within the same account balance or class of transactions; however, the risk that further undetected misstatements may exist is considered before concluding that offsetting even immaterial misstatements is appropriate.[11]

A15. Determining whether a classification misstatement is material involves the evaluation of qualitative considerations, such as the effect of the classification misstatement on debt or other contractual covenants, the effect on individual line items or sub-totals, or the effect on key ratios. There may be circumstances where the auditor concludes that a classification misstatement is not material in the context of the financial statements as a whole, even though it may exceed the materiality level or levels applied in evaluating other misstatements. For example, a misclassification between balance sheet line items may not be considered material in the context of the financial statements as a whole when the amount of the misclassification is small in relation to the size of the related balance sheet line items and the misclassification does not affect the income statement or any key ratios.

A16. The circumstances related to some misstatements may cause the auditor to evaluate them as material, individually or when considered together with other misstatements accumulated during the audit, even if they are lower than materiality for the financial statements as a whole. Circumstances that may affect the evaluation include the extent to which the misstatement:

- Affects compliance with regulatory requirements;
- Affects compliance with debt covenants or other contractual requirements;
- Relates to the incorrect selection or application of an accounting policy that has an immaterial effect on the current period's financial statements but is likely to have a material effect on future periods' financial statements;
- Masks a change in earnings or other trends, especially in the context of general economic and industry conditions;
- Affects ratios used to evaluate the entity's financial position, results of operations or cash flows;
- Affects segment information presented in the financial statements (for example, the significance of the matter to a segment or other portion of the entity's business that has been identified as playing a significant role in the entity's operations or profitability);
- Has the effect of increasing management compensation, for example, by ensuring that the requirements for the award of bonuses or other incentives are satisfied;

[11] The identification of a number of immaterial misstatements within the same account balance or class of transactions may require the auditor to reassess the risk of material misstatement for that account balance or class of transactions.

- Is significant having regard to the auditor's understanding of known previous communications to users, for example, in relation to forecast earnings;

- Relates to items involving particular parties (for example, whether external parties to the transaction are related to members of the entity's management);

- Is an omission of information not specifically required by the applicable financial reporting framework but which, in the judgment of the auditor, is important to the users' understanding of the financial position, financial performance or cash flows of the entity; or

- Affects other information ~~that will be communicated~~ to be included in the entity's annual report ~~documents containing the audited financial statements~~ (for example, information to be included in a "Management Discussion and Analysis" or an "Operating and Financial Review") that may reasonably be expected to influence the economic decisions of the users of the financial statements. HKSA 720 (Revised)[12] deals with the auditor's responsibilities relating to ~~consideration of~~ other information~~, on which the auditor has no obligation to report, in documents containing audited financial statements~~.

These circumstances are only examples; not all are likely to be present in all audits nor is the list necessarily complete. The existence of any circumstances such as these does not necessarily lead to a conclusion that the misstatement is material.

A17. HKSA 240[13] explains how the implications of a misstatement that is, or may be, the result of fraud ought to be considered in relation to other aspects of the audit, even if the size of the misstatement is not material in relation to the financial statements.

A18. The cumulative effect of immaterial uncorrected misstatements related to prior periods may have a material effect on the current period's financial statements. There are different acceptable approaches to the auditor's evaluation of such uncorrected misstatements on the current period's financial statements. Using the same evaluation approach provides consistency from period to period.

Considerations Specific to Public Sector Entities

A19. In the case of an audit of a public sector entity, the evaluation whether a misstatement is material may also be affected by the auditor's responsibilities established by law, regulation or other authority to report specific matters, including, for example, fraud.

A20. Furthermore, issues such as public interest, accountability, probity and ensuring effective legislative oversight, in particular, may affect the assessment whether an item is material by virtue of its nature. This is particularly so for items that relate to compliance with law, regulation or other authority.

Communication with Those Charged with Governance (Ref: Para. 12)

A21. If uncorrected misstatements have been communicated with person(s) with management responsibilities, and those person(s) also have governance responsibilities, they need not be communicated again with those same person(s) in their governance role. The auditor nonetheless has to be satisfied that communication with person(s) with management

[12] HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information ~~in Documents Containing Audited Financial Statements.~~*

[13] HKSA 240, paragraph 35.

responsibilities adequately informs all of those with whom the auditor would otherwise communicate in their governance capacity.[14]

A22. Where there is a large number of individual immaterial uncorrected misstatements, the auditor may communicate the number and overall monetary effect of the uncorrected misstatements, rather than the details of each individual uncorrected misstatement.

A23. HKSA 260 requires the auditor to communicate with those charged with governance the written representations the auditor is requesting (see paragraph 14 of this HKSA).[15] The auditor may discuss with those charged with governance the reasons for, and the implications of, a failure to correct misstatements, having regard to the size and nature of the misstatement judged in the surrounding circumstances, and possible implications in relation to future financial statements.

Written Representations (Ref: Para. 14)

A24. Because the preparation of the financial statements requires management and, where appropriate, those charged with governance to adjust the financial statements to correct material misstatements, the auditor is required to request them to provide a written representation about uncorrected misstatements. In some circumstances, management and, where appropriate, those charged with governance may not believe that certain uncorrected misstatements are misstatements. For that reason, they may want to add to their written representation words such as: "We do not agree that items … and … constitute misstatements because [description of reasons]." Obtaining this representation does not, however, relieve the auditor of the need to form a conclusion on the effect of uncorrected misstatements.

Documentation (Ref: Para. 15)

A25. The auditor's documentation of uncorrected misstatements may take into account:

(a) The consideration of the aggregate effect of uncorrected misstatements;

(b) The evaluation of whether the materiality level or levels for particular classes of transactions, account balances or disclosures, if any, have been exceeded; and

(c) The evaluation of the effect of uncorrected misstatements on key ratios or trends, and compliance with legal, regulatory and contractual requirements (for example, debt covenants).

[14] HKSA 260, paragraph 13.

[15] HKSA 260, paragraph 16(c)(ii).

HKSA 500

Issued July 2009; revised July 2010, May 2013,

February 2015*, August 2015**

Effective for audits of financial statements

for periods beginning on or after 15 December 2009

Hong Kong Standard on Auditing 500

Audit Evidence

** Conforming amendments have been made to this HKSA as a result of the new and revised HKSAs issued in Update 172, and will become effective for audits of financial statements for periods ending on or after 15 December 2016. The conforming amendments are underlined for easy reference.

* Conforming amendments have been made to this HKSA as a result of HKSA 610 (Revised), *Using the Work of Internal Auditors*, and are effective for audits of financial statements for periods ended on or after 15 December 2013. The conforming amendments are set out in the Consolidated Table of Changes in Update 166 issued in February 2015.

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HONG KONG STANDARD ON AUDITING 500

AUDIT EVIDENCE

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

CONTENTS

Hong Kong Standard on Auditing (HKSA) 500, "Audit Evidence" should be read in conjunction with HKSA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing."

Introduction

Scope of this HKSA

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

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

Effective Date

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

Objective

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

Definitions

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

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

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

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

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

2 HKSA 570, "Going Concern."

3 HKSA 520, "Analytical Procedures."

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

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

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

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

Requirements

Sufficient Appropriate Audit Evidence

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

Information to Be Used as Audit Evidence

7. When designing and performing audit procedures, the auditor shall consider the relevance and reliability of the information to be used as audit evidence. (Ref: Para. A26-A33)

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. A34-A36)

   (a) Evaluate the competence, capabilities and objectivity of that expert; (Ref: Para. A37-A43)

   (b) Obtain an understanding of the work of that expert; and (Ref: Para. A44-A47)

   (c) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion. (Ref: Para. A48)

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. A49-A50)

   (b) Evaluating whether the information is sufficiently precise and detailed for the auditor's purposes. (Ref: Para. A51)

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. A52-A56)

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. A57)

Conformity and Compliance with International Standards on Auditing

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

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Application and Other Explanatory Material

Sufficient Appropriate Audit Evidence (Ref: Para. 6)

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

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

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

[6] HKSA 315 (Revised), paragraph 9.

[7] HKSA 200, paragraph 5.

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

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

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

Sources of Audit Evidence

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

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

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

Audit Procedures for Obtaining Audit Evidence

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

(a) Risk assessment procedures; and

(b) Further audit procedures, which comprise:

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

[8] HKSA 330, paragraph 26.

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

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

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

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

Inspection

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

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

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

Observation

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

[9] HKSA 330, paragraph A35.

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

External Confirmation

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

Recalculation

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

Reperformance

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

Analytical Procedures

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

Inquiry

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

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

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

[11] HKSA 505, "External Confirmations."

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

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

Information to Be Used as Audit Evidence

Relevance and Reliability (Ref: Para. 7)

A26. As noted in paragraph A1, while audit evidence is primarily obtained from audit procedures performed during the course of the audit, it may also include information obtained from other sources such as, for example, previous audits, in certain circumstances, and a firm's quality control procedures for client acceptance and continuance. The quality of all audit evidence is affected by the relevance and reliability of the information upon which it is based.

Relevance

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

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

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

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

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[12] HKSA 580, "Written Representations."

Reliability

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

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

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

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

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

A34. 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.

[13] HKSA 520, paragraph 5(a).

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

A35. When information to be used as audit evidence has been prepared using the work of a management's expert, the requirement in paragraph 8 of this HKSA applies. For example, an individual or organization may possess expertise in the application of models to estimate the fair value of securities for which there is no observable market. If the individual or organization applies that expertise in making an estimate which the entity uses in preparing its financial statements, the individual or organization is a management's expert and paragraph 8 applies. If, on the other hand, that individual or organization merely provides price data regarding private transactions not otherwise available to the entity which the entity uses in its own estimation methods, such information, if used as audit evidence, is subject to paragraph 7 of this HKSA, but is not the use of a management's expert by the entity.

A36. The nature, timing and extent of audit procedures in relation to the requirement in paragraph 8 of this HKSA, may be affected by such matters as:

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

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

A37. Competence relates to the nature and level of expertise of the management's expert. Capability relates the ability of the management's expert to exercise that competence in the circumstances. Factors that influence capability may include, for example, geographic location, and the availability of time and resources. Objectivity relates to the possible effects that bias, conflict of interest or the influence of others may have on the professional or business judgment of the management's expert. The competence, capabilities and objectivity of a management's expert, and any controls within the entity over that expert's work, are important factors in relation to the reliability of any information produced by a management's expert.

A38. 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.

A39. 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.

A40. 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.

A41. 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).

A42. 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.

A43. 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))

A44. 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.[15]

A45. 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.

A46. 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.

A47. 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.

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[15] HKSA 620, "Using the Work of an Auditor's Expert," paragraph 7.

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

A48. Considerations when evaluating the appropriateness of the management's expert's work as audit evidence for the relevant assertion may include:

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

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

A49. 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.

A50. 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.

A51. 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)

A52. 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

A53. 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

A54. 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.

A55. 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

A56. 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.[16]

[16] HKSA 530, "Audit Sampling."

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

A57. 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.[17]

[17] HKSA 230, "Audit Documentation," paragraph 11.

HKSA 510

Issued September 2009; revised July 2010,

June 2014*, August 2015**

Effective for audits of financial statements

for periods beginning on or after 15 December 2009

Hong Kong Standard on Auditing 510

Initial Audit Engagements —Opening Balances

** Conforming amendments have been made to this HKSA as a result of the new and revised HKSAs issued in Update 172, and will become effective for audits of financial statements for periods ending on or after 15 December 2016. The conforming amendments are underlined for easy reference.

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

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

HONG KONG STANDARD ON AUDITING 510

INITIAL AUDIT ENGAGEMENTS—OPENING BALANCES

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

CONTENTS

Hong Kong Standard on Auditing (HKSA) 510, "Initial Audit Engagements—Opening Balances" should be read in conjunction with HKSA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing."

Introduction

Scope of this HKSA

1. This Hong Kong Standard on Auditing (HKSA) deals with the auditor's responsibilities relating to opening balances in an initial audit engagement. In addition to financial statement amounts, opening balances include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments. When the financial statements include comparative financial information, the requirements and guidance in HKSA 710 [1] also apply. HKSA 300 [2] includes additional requirements and guidance regarding activities prior to starting an initial audit.

Effective Date

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

Objective

3. In conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether:

   (a) Opening balances contain misstatements that materially affect the current period's financial statements; and

   (b) Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are appropriately accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

Definitions

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

   (a) Initial audit engagement – An engagement in which either:

      (i) The financial statements for the prior period were not audited; or

      (ii) The financial statements for the prior period were audited by a predecessor auditor.

   (b) Opening balances – Those account balances that exist at the beginning of the period. Opening balances are based upon the closing balances of the prior period and reflect the effects of transactions and events of prior periods and accounting policies applied in the prior period. Opening balances also include matters requiring disclosure that existed at the beginning of the period, such as contingencies and commitments.

   (c) Predecessor auditor – The auditor from a different audit firm, who audited the financial statements of an entity in the prior period and who has been replaced by the current auditor.

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[1] HKSA 710, "Comparative Information—Corresponding Figures and Comparative Financial Statements."

[2] HKSA 300, "Planning an Audit of Financial Statements."

Requirements

Audit Procedures

Opening Balances

5. The auditor shall read the most recent financial statements, if any, and the predecessor auditor's report thereon, if any, for information relevant to opening balances, including disclosures.

6. The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by: (Ref: Para. A1–A2)

   (a) Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, have been restated;

   (b) Determining whether the opening balances reflect the application of appropriate accounting policies; and

   (c) Performing one or more of the following: (Ref: Para. A3–A7)

      (i) Where the prior year financial statements were audited, reviewing the predecessor auditor's working papers to obtain evidence regarding the opening balances;

      (ii) Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or

      (iii) Performing specific audit procedures to obtain evidence regarding the opening balances.

7. If the auditor obtains audit evidence that the opening balances contain misstatements that could materially affect the current period's financial statements, the auditor shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statements. If the auditor concludes that such misstatements exist in the current period's financial statements, the auditor shall communicate the misstatements with the appropriate level of management and those charged with governance in accordance with HKSA 450.[3]

Consistency of Accounting Policies

8. The auditor shall obtain sufficient appropriate audit evidence about whether the accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, and whether changes in the accounting policies have been appropriately accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

Relevant Information in the Predecessor Auditor's Report

9. If the prior period's financial statements were audited by a predecessor auditor and there was a modification to the opinion, the auditor shall evaluate the effect of the matter giving rise to the modification in assessing the risks of material misstatement in the current period's financial statements in accordance with HKSA 315.[4]

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[3] HKSA 450, "Evaluation of Misstatements Identified during the Audit," paragraphs 8 and 12.

[4] HKSA 315, "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment."

Audit Conclusions and Reporting

Opening Balances

10. If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or disclaim an opinion on the financial statements, as appropriate, in accordance with HKSA 705.[5] (Ref: Para. A8)

11. If the auditor concludes that the opening balances contain a misstatement that materially affects the current period's financial statements, and the effect of the misstatement is not appropriately accounted for or not adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion, as appropriate, in accordance with HKSA 705.

Consistency of Accounting Policies

12. If the auditor concludes that:

    (a) the current period's accounting policies are not consistently applied in relation to opening balances in accordance with the applicable financial reporting framework; or

    (b) a change in accounting policies is not appropriately accounted for or not adequately presented or disclosed in accordance with the applicable financial reporting framework,

    the auditor shall express a qualified opinion or an adverse opinion as appropriate in accordance with HKSA 705.

Modification to the Opinion in the Predecessor Auditor's Report

13. If the predecessor auditor's opinion regarding the prior period's financial statements included a modification to the auditor's opinion that remains relevant and material to the current period's financial statements, the auditor shall modify the auditor's opinion on the current period's financial statements in accordance with HKSA 705 and HKSA 710. (Ref: Para. A9)

Conformity and Compliance with International Standards on Auditing

14. As of September 2009 (date of issue), this HKSA conforms with International Standard on Auditing (ISA) 510, "Initial Audit Engagements—Opening Balances". Compliance with the requirements of this HKSA ensures compliance with ISA 510.

15. Additional local explanation and guidance is provided in footnote 5a and Appendix.

***

Application and Other Explanatory Material

Audit Procedures

Considerations Specific to Public Sector Entities (Ref: Para. 6)

A1. In the public sector, there may be legal or regulatory limitations on the information that the current auditor can obtain from a predecessor auditor. For example, if a public sector entity that has previously been audited by a statutorily appointed auditor (for example, an Auditor General, or other suitably qualified person appointed on behalf of the Auditor General) is

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

privatized, the amount of access to working papers or other information that the statutorily appointed auditor can provide a newly-appointed auditor that is in the private sector may be constrained by privacy or secrecy laws or regulations. In situations where such communications are constrained, audit evidence may need to be obtained through other means and, if sufficient appropriate audit evidence cannot be obtained, consideration given to the effect on the auditor's opinion.

A2. If the statutorily appointed auditor outsources an audit of a public sector entity to a private sector audit firm, and the statutorily appointed auditor appoints an audit firm other than the firm that audited the financial statements of the public sector entity in the prior period, this is not usually regarded as a change in auditors for the statutorily appointed auditor. Depending on the nature of the outsourcing arrangement, however, the audit engagement may be considered an initial audit engagement from the perspective of the private sector auditor in fulfilling the auditor's responsibilities, and therefore this HKSA applies.

Opening Balances (Ref: Para. 6(c))

A3. The nature and extent of audit procedures necessary to obtain sufficient appropriate audit evidence regarding opening balances depend on such matters as:

- The accounting policies followed by the entity.
- The nature of the account balances, classes of transactions and disclosures and the risks of material misstatement in the current period's financial statements.
- The significance of the opening balances relative to the current period's financial statements.
- Whether the prior period's financial statements were audited and, if so, whether the predecessor auditor's opinion was modified.

A4. If the prior period's financial statements were audited by a predecessor auditor, the auditor may be able to obtain sufficient appropriate audit evidence regarding the opening balances by reviewing the predecessor auditor's working papers. Whether such a review provides sufficient appropriate audit evidence is influenced by the professional competence and independence of the predecessor auditor.

A5. Relevant ethical and professional requirements guide the current auditor's communications with the predecessor auditor.

A6. For current assets and liabilities, some audit evidence about opening balances may be obtained as part of the current period's audit procedures. For example, the collection (payment) of opening accounts receivable (accounts payable) during the current period will provide some audit evidence of their existence, rights and obligations, completeness and valuation at the beginning of the period. In the case of inventories, however, the current period's audit procedures on the closing inventory balance provide little audit evidence regarding inventory on hand at the beginning of the period. Therefore, additional audit procedures may be necessary, and one or more of the following may provide sufficient appropriate audit evidence:

- Observing a current physical inventory count and reconciling it to the opening inventory quantities.
- Performing audit procedures on the valuation of the opening inventory items.
- Performing audit procedures on gross profit and cutoff.

A7. For non-current assets and liabilities, such as property, plant and equipment, investments and long-term debt, some audit evidence may be obtained by examining the accounting records and other information underlying the opening balances. In certain cases, the auditor may be able to obtain some audit evidence regarding opening balances through confirmation with third parties, for example, for long-term debt and investments. In other cases, the auditor may need to carry out additional audit procedures.

Audit Conclusions and Reporting

Opening Balances (Ref: Para. 10)

A8. HKSA 705 establishes requirements and provides guidance on circumstances that may result in a modification to the auditor's opinion on the financial statements, the type of opinion appropriate in the circumstances, and the content of the auditor's report when the auditor's opinion is modified. The inability of the auditor to obtain sufficient appropriate audit evidence regarding opening balances may result in one of the following modifications to the opinion in the auditor's report:

(a) A qualified opinion or a disclaimer of opinion, as is appropriate in the circumstances; or

(b) Unless prohibited by law or regulation, an opinion which is qualified or disclaimed, as appropriate, regarding the results of operations, and cash flows, where relevant, and unmodified regarding financial position.[5a]

The Appendix includes illustrative auditors' reports.

Modification to the Opinion in the Predecessor Auditor's Report (Ref: Para. 13)

A9. In some situations, a modification to the predecessor auditor's opinion may not be relevant and material to the opinion on the current period's financial statements. This may be the case where, for example, there was a scope limitation in the prior period, but the matter giving rise to the scope limitation has been resolved in the current period.

[5a] This form of opinion is permitted in Hong Kong.

Appendix

(Ref: Para. A8)

Illustrations of Auditors' Reports with Modified Opinions

Illustration 1:

For purposes of this illustrative auditor's report, the following ~~C~~circumstances ~~described in paragraph A8(a) include the following~~are assumed:

- Audit of a complete set of financial statements of an entity other than a listed entity using Hong Kong Financial Reporting Standards (HKFRSs). The audit is not a group audit (i.e., HKSA 600[1] does not apply).
- The financial statements are prepared by management of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in HKSA 210.[2]
- The auditor did not observe the counting of the physical inventory at the beginning of the current period and was unable to obtain sufficient appropriate audit evidence regarding the opening balances of inventory.
- The possible effects of the inability to obtain sufficient appropriate audit evidence regarding opening balances of inventory are deemed to be material but not pervasive to the entity's financial performance and cash flows.[3]
- The financial position at year end is fairly presented.
- In this particular jurisdiction, law and regulation prohibit the auditor from giving an opinion which is qualified regarding the financial performance and cash flows and unmodified regarding financial position.[~~1a~~3a]
- The relevant ethical requirements that apply to the audit are those of the jurisdiction.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).[4]
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with HKSA 701.[5]
- The auditor has obtained all of the other information prior to the date of the auditor's report and

[1] HKSA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

[2] HKSA 210, *Agreeing the Terms of Audit Engagements*

[3] If the possible effects, in the auditor's judgment, are considered to be material and pervasive to the entity's financial performance and cash flows, the auditor would disclaim an opinion on the financial performance and cash flows.

~~[1a] This form of opinion is permitted in Hong Kong.~~

[3a] This form of opinion is permitted in Hong Kong.

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

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

has not identified a material misstatement of the other information.

- Corresponding figures are presented, and the prior period's financial statements were audited by a predecessor auditor. The auditor is not prohibited by law or regulation from referring to the predecessor auditor's report on the corresponding figures and has decided to do so.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- ~~The entity is incorporated overseas and has reporting in Hong Kong~~In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law.

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of ABC Company ~~TO THE~~ [or Other Appropriate Addressee~~APPROPRIATE ADDRESSEE~~] ~~OF ABC LIMITED~~

~~(incorporated in [country or place] with limited liability)~~ ~~[1b]~~

~~[~~Report on the Audit of the Financial Statements~~]~~[6]

Qualified Opinion

We have audited the financial statements of ABC ~~Limited~~ Company ("the Company") set out on pages …… to ……, which comprise the statement of financial position as at 31 December 20X1, and [the statement of profit or loss and] ~~[2a]~~[6a] the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies ~~and other explanatory information~~.

In our opinion, except for the possible effects of the matter described in the *Basis for Qualified Opinion* section of our report, 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").

Basis for Qualified Opinion

We were appointed as auditors of the Company on 30 June 20X1 and thus did not observe the counting of the physical inventories at the beginning of the year. We were unable to satisfy ourselves by alternative means concerning inventory quantities held at 31 December 20X0. Since opening inventories enter into the determination of the financial performance and cash flows, we were unable to determine whether adjustments might have been necessary in respect of the financial performance

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

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

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

[6a] HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.

for the year reported in the [statement of profit or loss and other comprehensive income][statement of profit or loss and statement of profit or loss and other comprehensive income][6a] and the net cash flows from operating activities reported in the statement of cash flows.

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") 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 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. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Other Matter

The financial statements of the Company for the year ended 31 December 20X0 were audited by another auditor who expressed an unmodified opinion on those statements on 31 March 20X1.

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'~~Management and Those Charged with Governance for the Financial Statements[7] ~~*Responsibility for the Financial Statements*~~

[*Reporting in accordance with HKSA 700 (Revised)*[8] *– see Illustration 3 in HKSA 700 (Revised*).]

~~The directors are responsible for the preparation of financial statements that give a true and fair view in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants [and the disclosure requirements of the Hong Kong Companies Ordinance[4a]], and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.~~

Auditor's Responsibility~~y~~ies for the Audit of the Financial Statements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 3 in HKSA 700 (Revised*).]

~~Our responsibility is to express an opinion on these financial statements based on our audit[4b]. We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.~~

~~An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in~~

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[7] Throughout these illustrative auditor's reports, the~~Or other~~ terms management and those charged with governance may need to be replaced by another term that is appropriate in the context of the legal framework in the particular jurisdiction.

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

~~[9] Not used.~~

~~[4a] For a company incorporated overseas and listed in Hong Kong, the disclosure requirements of the Hong Kong Companies Ordinance are applicable.~~

~~[4b] Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".~~

~~the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.[11] An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.~~

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

~~*Basis for Qualified Opinion*~~

~~We were appointed as auditors of the Company on 30 June 20X1 and thus did not observe the counting of the physical inventories at the beginning of the year. We were unable to satisfy ourselves by alternative means concerning inventory quantities held at 31 December 20X0. Since opening inventories enter into the determination of the financial performance and cash flows, we were unable to determine whether adjustments might have been necessary in respect of the financial performance for the year reported in the [statement of profit or loss and other comprehensive income][statement of profit or loss and statement of profit or loss and other comprehensive income][2a] and the net cash flows from operating activities reported in the statement of cash flows.~~

~~*Qualified Opinion*~~

~~In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements give a true and fair view of the financial position of the Company as at 31 December 20X1, and of its financial performance and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards [and have been properly prepared in compliance with the disclosure requirements of the Hong Kong Companies Ordinance][4a].~~

~~*Other Matter*~~

~~The financial statements of the Company for the year ended 31 December 20X0 were audited by another auditor who expressed an unmodified opinion on those statements on 31 March 20X1.~~

~~[~~Report on Other Legal and Regulatory Requirements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 3 in HKSA 700 (Revised*).]

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

XYZ & Co.

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

[*Auditor's ~~a~~Address*]

[*Date*] ~~of the auditor's report~~

~~[10] Not used.~~

~~[11] In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances."~~

Illustration 2:

For purposes of this illustrative auditor's report, the following ~~C~~circumstances ~~described in paragraph A8(b) include the following~~are assumed:

- Audit of a complete set of financial statements of an entity other than a listed entity using Hong Kong Financial Reporting Standards (HKFRSs). The audit is not a group audit (i.e., HKSA 600 does not apply).
- The financial statements are prepared by the directors of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of the directors' responsibility for the financial statements in HKSA 210.
- The auditor did not observe the counting of the physical inventory at the beginning of the current period and was unable to obtain sufficient appropriate audit evidence regarding the opening balances of inventory.
- The possible effects of the inability to obtain sufficient appropriate audit evidence regarding opening balances of inventory are deemed to be material but not pervasive to the entity's financial performance and cash flows.[9]
- The financial position at year end is fairly presented.
- An opinion that is qualified regarding the financial performance and cash flows and unmodified regarding financial position is considered appropriate in the circumstances.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with HKSA 701.
- The auditor has obtained all of the other information prior to the date of the auditor's report and has not identified a material misstatement of the other information.
- Corresponding figures are presented, and the prior period's financial statements were audited by a predecessor auditor. The auditor is not prohibited by law or regulation from referring to the predecessor auditor's report on the corresponding figures and has decided to do so.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance.
- ~~The information in the directors' report is not consistent with the financial statements.~~

[9] If the possible effects, in the auditor's judgment, are considered to be material and pervasive to the entity's financial performance and cash flows, the auditor would disclaim the opinion on the financial performance and cash flows.

INDEPENDENT AUDITOR'S REPORT

~~TO THE MEMBERS OF ABC LIMITED~~To the Members of ABC Company

(incorporated in Hong Kong with limited liability)[~~7a~~9a]

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of ABC ~~Limited~~ Company ("the Company") set out on pages …… to ……, which comprise the statement of financial position as at 31 December 20X1, and [the statement of profit or loss and][~~8a~~10a] the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies ~~and other explanatory information~~.

Qualified Opinion on the Financial Performance and Cash Flows

In our opinion, except for the possible effects of the matter described in the *Basis for Qualified Opinion* section of our report, the [statement of profit or loss and other comprehensive income][statement of profit or loss and statement of profit or loss and other comprehensive income][10a] and statement of cash flows give a true and fair view of the financial performance and cash flows of the Company for the year ended 31 December 20X1 in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Opinion on the Financial Position

In our opinion, the statement of financial position gives a true and fair view of the financial position of the Company as at 31 December 20X1 in accordance with HKFRSs and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Opinions, Including Basis for Qualified Opinion on the Financial Performance and Cash Flows

We were appointed as auditors of the Company on 30 June 20X1 and thus did not observe the counting of the physical inventories at the beginning of the year. We were unable to satisfy ourselves by alternative means concerning inventory quantities held at 31 December 20X0. Since opening inventories enter into the determination of the financial performance and cash flows, we were unable to determine whether adjustments might have been necessary in respect of the financial performance for the year reported in the [statement of profit or loss and other comprehensive income][statement of

~~7a In Hong Kong, it is a common practice to disclose the place of incorporation of the company.~~

9a In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

10 Not used.

~~8a HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.~~

10a HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.

profit or loss and statement of profit or loss and other comprehensive income][10a] and the net cash flows from operating activities reported in the statement of cash flows.

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") 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"), and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our unmodified opinion on the financial position and our qualified audit opinion on the financial performance and cash flows.

Other Matter

The financial statements of the Company for the year ended 31 December 20X0 were audited by another auditor who expressed an unmodified opinion on those statements on 31 March 20X1.

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 Statements[11] **~~Responsibility for the Financial Statements~~**

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 3 in HKSA 700 (Revised*).]

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

Auditor's Responsibilitiesy~~y~~ for the Audit of the Financial Statements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 3 in HKSA 700 (Revised*).]

~~Our responsibility is to express an opinion on these financial statements based on our audit[10a]. We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.~~

~~An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the~~

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11 Or other terms that ~~is~~ are appropriate in the context of the legal framework in the particular jurisdiction.

~~12 Not used.~~

~~10a Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".~~

~~13 Not used.~~

~~effectiveness of the entity's internal control.[14] An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.~~

~~We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our unmodified opinion on the financial position and our qualified audit opinion on the financial performance and cash flows.~~

~~Basis for Qualified Opinion on the Financial Performance and Cash Flows~~

~~We were appointed as auditors of the Company on 30 June 20X1 and thus did not observe the counting of the physical inventories at the beginning of the year. We were unable to satisfy ourselves by alternative means concerning inventory quantities held at 31 December 20X0. Since opening inventories enter into the determination of the financial performance and cash flows, we were unable to determine whether adjustments might have been necessary in respect of the financial performance for the year reported in the [statement of profit or loss and other comprehensive income][statement of profit or loss and statement of profit or loss and other comprehensive income][8a] and the net cash flows from operating activities reported in the statement of cash flows.~~

~~Qualified Opinion on the Financial Performance and Cash Flows~~

~~In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion paragraph, the [statement of profit or loss and other comprehensive income][statement of profit or loss and statement of profit or loss and other comprehensive income][8a] and statement of cash flows give a true and fair view of the Company's financial performance and cash flows for the year ended 31 December 20X1 in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in compliance with the Hong Kong Companies Ordinance.~~

~~Opinion on the Financial Position~~

~~In our opinion, the statement of financial position gives a true and fair view of the financial position of the Company as at 31 December 20X1 in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in compliance with the Hong Kong Companies Ordinance.~~

~~Other Matter~~

~~The financial statements of the Company for the year ended 31 December 20X0 were audited by another auditor who expressed an unmodified opinion on those statements on 31 March 20X1.~~

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

Report on ~~[Directors' Report under section 406(2) and]~~ ~~[15]~~ Other Matters under sections 407(2)[12] and 407(3)~~[14]~~ [12] of the Hong Kong Companies Ordinance[13]

~~[Directors' and Auditor's Respective Responsibility for the Directors' Report[13]~~

~~In addition to the respective responsibilities of the directors and auditor stated in above section "Report on the Financial Statements", the directors are also responsible for the preparation of the directors' report as set out on pages … to … in accordance with the Hong Kong Companies Ordinance.~~

~~It is our responsibility to read the information in the directors' report for the year ended 31 December 20X1 as set out on pages … to … to identify and report inconsistencies with the financial statements. However, we have not audited or reviewed the directors' report and accordingly do not express an audit opinion or a review conclusion or any assurance conclusion on the directors' report as a whole.]~~

~~**Matters on which we are required to report by exception**~~

~~In accordance with the Hong Kong Companies Ordinance, we have the following matters to report. In our opinion:~~

- ~~[the information given in [*insert relevant paragraph/ section*] in the directors' report for the year ended 31 December 20X1 is not consistent with the financial statements for the year ended 31 December 20X1. [*State the details of the inconsistencies*[13].]]~~

~~•~~ ~~i~~In respect alone of the inability to obtain sufficient appropriate audit evidence regarding opening balances of inventory as described in the *Basis for Qualified Opinion* ~~paragraph~~ section of our report above:

- we were unable to determine whether adequate accounting records had been kept; and
- we have not obtained all the information and explanations that, to the best of our knowledge and belief, are necessary and material for the purpose of the audit.

~~15~~ ~~Section 406(2) of the Hong Kong Companies Ordinance (CO) requires the auditor to opine on the directors' report:~~

~~(2) If a company's auditor is of the opinion that the information in a directors' report for a financial year is not consistent with the financial statements for the financial year, the auditor-~~

~~(a) must state that opinion in the auditor's report; and~~

~~(b) may bring that opinion to the members' attention at a general meeting.~~

12 Section 407 of the CO requires the auditor to opine on other matters:

(1) In preparing an auditor's report, the auditor must carry out an investigation that will enable the auditor to form an opinion as to—
  (a) whether adequate accounting records have been kept by the company; and
  (b) whether the financial statements are in agreement with the accounting records.

(2) A company's auditor must state the auditor's opinion in the auditor's report if the auditor is of the opinion that—
  (a) adequate accounting records have not been kept by the company; or
  (b) the financial statements are not in agreement with the accounting records in any material respect.

(3) If a company's auditor fails to obtain all the information or explanations that, to the best of the auditor's knowledge and belief, are necessary and material for the purpose of the audit, the auditor must state that fact in the auditor's report.

(4) If the financial statements do not comply with section 383(1), the auditor must include in the auditor's report, so far as the auditor is reasonably able to do so, a statement giving the particulars that are required to be, but have not been, contained in the financial statements.

Where the opinion on the financial statements has been modified, the auditor needs to evaluate what the consequences of this modification are on the reporting requirement under the CO, and further modify the report if necessary.

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

XYZ & Co.

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

[*Auditor's* *A~~a~~ddress*]

[*Date*] ~~of the auditor's report~~

HKSA 540
Issued July 2009; revised July 2010, August 2015*

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

Hong Kong Standard on Auditing 540

Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures

*	Conforming amendments have been made to this HKSA as a result of the new and revised HKSAs issued in Update 172, and will become effective for audits of financial statements for periods ending on or after 15 December 2016. The conforming amendments are underlined for easy reference.

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

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HONG KONG STANDARD ON AUDITING 540

AUDITING ACCOUNTING ESTIMATES, INCLUDING FAIR VALUE ACCOUNTING ESTIMATES, AND RELATED DISCLOSURES

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

CONTENTS

Hong Kong Standard on Auditing (HKSA) 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures" should be read in conjunction with HKSA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing."

Introduction

Scope of this HKSA

1. This Hong Kong Standard on Auditing (HKSA) deals with the auditor's responsibilities relating to accounting estimates, including fair value accounting estimates, and related disclosures in an audit of financial statements. Specifically, it expands on how HKSA 315 [1] and HKSA 330 [2] and other relevant HKSAs are to be applied in relation to accounting estimates. It also includes requirements and guidance on misstatements of individual accounting estimates, and indicators of possible management bias.

Nature of Accounting Estimates

2. Some financial statement items cannot be measured precisely, but can only be estimated. For purposes of this HKSA, such financial statement items are referred to as accounting estimates. The nature and reliability of information available to management to support the making of an accounting estimate varies widely, which thereby affects the degree of estimation uncertainty associated with accounting estimates. The degree of estimation uncertainty affects, in turn, the risks of material misstatement of accounting estimates, including their susceptibility to unintentional or intentional management bias. (Ref: Para. A1-A11)

3. The measurement objective of accounting estimates can vary depending on the applicable financial reporting framework and the financial item being reported. The measurement objective for some accounting estimates is to forecast the outcome of one or more transactions, events or conditions giving rise to the need for the accounting estimate. For other accounting estimates, including many fair value accounting estimates, the measurement objective is different, and is expressed in terms of the value of a current transaction or financial statement item based on conditions prevalent at the measurement date, such as estimated market price for a particular type of asset or liability. For example, the applicable financial reporting framework may require fair value measurement based on an assumed hypothetical current transaction between knowledgeable, willing parties (sometimes referred to as "marketplace participants" or equivalent) in an arm's length transaction, rather than the settlement of a transaction at some past or future date.[3]

4. A difference between the outcome of an accounting estimate and the amount originally recognized or disclosed in the financial statements does not necessarily represent a misstatement of the financial statements. This is particularly the case for fair value accounting estimates, as any observed outcome is invariably affected by events or conditions subsequent to the date at which the measurement is estimated for purposes of the financial statements.

Effective Date

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

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[1] HKSA 315, "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment."

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

[3] Different definitions of fair value may exist among financial reporting frameworks.

Objective

6. The objective of the auditor is to obtain sufficient appropriate audit evidence about whether:

   (a) accounting estimates, including fair value accounting estimates, in the financial statements, whether recognized or disclosed, are reasonable; and

   (b) related disclosures in the financial statements are adequate,

   in the context of the applicable financial reporting framework.

Definitions

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

   (a) Accounting estimate – An approximation of a monetary amount in the absence of a precise means of measurement. This term is used for an amount measured at fair value where there is estimation uncertainty, as well as for other amounts that require estimation. Where this HKSA addresses only accounting estimates involving measurement at fair value, the term "fair value accounting estimates" is used.

   (b) Auditor's point estimate or auditor's range – The amount, or range of amounts, respectively, derived from audit evidence for use in evaluating management's point estimate.

   (c) Estimation uncertainty – The susceptibility of an accounting estimate and related disclosures to an inherent lack of precision in its measurement.

   (d) Management bias – A lack of neutrality by management in the preparation of information.

   (e) Management's point estimate – The amount selected by management for recognition or disclosure in the financial statements as an accounting estimate.

   (f) Outcome of an accounting estimate –The actual monetary amount which results from the resolution of the underlying transaction(s), event(s) or condition(s) addressed by the accounting estimate.

Requirements

Risk Assessment Procedures and Related Activities

8. When performing risk assessment procedures and related activities to obtain an understanding of the entity and its environment, including the entity's internal control, as required by HKSA 315,[4] the auditor shall obtain an understanding of the following in order to provide a basis for the identification and assessment of the risks of material misstatement for accounting estimates: (Ref: Para. A12)

   (a) The requirements of the applicable financial reporting framework relevant to accounting estimates, including related disclosures. (Ref: Para. A13-A15)

[4] HKSA 315, paragraphs 5-6 and 11-12.

(b) How management identifies those transactions, events and conditions that may give rise to the need for accounting estimates to be recognized or disclosed in the financial statements. In obtaining this understanding, the auditor shall make inquiries of management about changes in circumstances that may give rise to new, or the need to revise existing, accounting estimates. (Ref: Para. A16-A21)

(c) How management makes the accounting estimates, and an understanding of the data on which they are based, including: (Ref: Para. A22-A23)

(i) The method, including where applicable the model, used in making the accounting estimate; (Ref: Para. A24-A26)

(ii) Relevant controls; (Ref: Para. A27-A28)

(iii) Whether management has used an expert; (Ref: Para. A29-A30)

(iv) The assumptions underlying the accounting estimates; (Ref: Para. A31-A36)

(v) Whether there has been or ought to have been a change from the prior period in the methods for making the accounting estimates, and if so, why; and (Ref: Para. A37)

(vi) Whether and, if so, how management has assessed the effect of estimation uncertainty. (Ref: Para. A38)

9. The auditor shall review the outcome of accounting estimates included in the prior period financial statements, or, where applicable, their subsequent re-estimation for the purpose of the current period. The nature and extent of the auditor's review takes account of the nature of the accounting estimates, and whether the information obtained from the review would be relevant to identifying and assessing risks of material misstatement of accounting estimates made in the current period financial statements. However, the review is not intended to call into question the judgments made in the prior periods that were based on information available at the time. (Ref: Para. A39-A44)

Identifying and Assessing the Risks of Material Misstatement

10. In identifying and assessing the risks of material misstatement, as required by HKSA 315,[5] the auditor shall evaluate the degree of estimation uncertainty associated with an accounting estimate. (Ref: Para. A45-A46)

11. The auditor shall determine whether, in the auditor's judgment, any of those accounting estimates that have been identified as having high estimation uncertainty give rise to significant risks. (Ref: Para. A47-A51)

Responses to the Assessed Risks of Material Misstatement

12. Based on the assessed risks of material misstatement, the auditor shall determine: (Ref: Para. A52)

(a) Whether management has appropriately applied the requirements of the applicable financial reporting framework relevant to the accounting estimate; and (Ref: Para. A53-A56)

[5] HKSA 315, paragraph 25.

(b) Whether the methods for making the accounting estimates are appropriate and have been applied consistently, and whether changes, if any, in accounting estimates or in the method for making them from the prior period are appropriate in the circumstances. (Ref: Para. A57-A58)

13. In responding to the assessed risks of material misstatement, as required by HKSA 330,[6] the auditor shall undertake one or more of the following, taking account of the nature of the accounting estimate: (Ref: Para. A59-A61)

(a) Determine whether events occurring up to the date of the auditor's report provide audit evidence regarding the accounting estimate. (Ref: Para. A62-A67)

(b) Test how management made the accounting estimate and the data on which it is based. In doing so, the auditor shall evaluate whether: (Ref: Para. A68-A70)

(i) The method of measurement used is appropriate in the circumstances; and (Ref: Para. A71-A76)

(ii) The assumptions used by management are reasonable in light of the measurement objectives of the applicable financial reporting framework. (Ref: Para. A77-A83)

(c) Test the operating effectiveness of the controls over how management made the accounting estimate, together with appropriate substantive procedures. (Ref: Para. A84-A86)

(d) Develop a point estimate or a range to evaluate management's point estimate. For this purpose: (Ref: Para. A87-A91)

(i) If the auditor uses assumptions or methods that differ from management's, the auditor shall obtain an understanding of management's assumptions or methods sufficient to establish that the auditor's point estimate or range takes into account relevant variables and to evaluate any significant differences from management's point estimate. (Ref: Para. A92)

(ii) If the auditor concludes that it is appropriate to use a range, the auditor shall narrow the range, based on audit evidence available, until all outcomes within the range are considered reasonable. (Ref: Para. A93-A95)

14. In determining the matters identified in paragraph 12 or in responding to the assessed risks of material misstatement in accordance with paragraph 13, the auditor shall consider whether specialized skills or knowledge in relation to one or more aspects of the accounting estimates are required in order to obtain sufficient appropriate audit evidence. (Ref: Para. A96-A101)

Further Substantive Procedures to Respond to Significant Risks

Estimation Uncertainty

15. For accounting estimates that give rise to significant risks, in addition to other substantive procedures performed to meet the requirements of HKSA 330,[7] the auditor shall evaluate the following: (Ref: Para. A102)

6 HKSA 330, paragraph 5.

7 HKSA 330, paragraph 18.

(a) How management has considered alternative assumptions or outcomes, and why it has rejected them, or how management has otherwise addressed estimation uncertainty in making the accounting estimate. (Ref: Para. A103-A106)

(b) Whether the significant assumptions used by management are reasonable. (Ref: Para. A107-A109)

(c) Where relevant to the reasonableness of the significant assumptions used by management or the appropriate application of the applicable financial reporting framework, management's intent to carry out specific courses of action and its ability to do so. (Ref: Para. A110)

16. If, in the auditor's judgment, management has not adequately addressed the effects of estimation uncertainty on the accounting estimates that give rise to significant risks, the auditor shall, if considered necessary, develop a range with which to evaluate the reasonableness of the accounting estimate. (Ref: Para. A111-A112)

Recognition and Measurement Criteria

17. For accounting estimates that give rise to significant risks, the auditor shall obtain sufficient appropriate audit evidence about whether:

(a) Management's decision to recognize, or to not recognize, the accounting estimates in the financial statements; and (Ref: Para. A113-A114)

(b) The selected measurement basis for the accounting estimates, (Ref: Para. A115)

are in accordance with the requirements of the applicable financial reporting framework.

Evaluating the Reasonableness of the Accounting Estimates, and Determining Misstatements

18. The auditor shall evaluate, based on the audit evidence, whether the accounting estimates in the financial statements are either reasonable in the context of the applicable financial reporting framework, or are misstated. (Ref: Para. A116-A119)

Disclosures Related to Accounting Estimates

19. The auditor shall obtain sufficient appropriate audit evidence about whether the disclosures in the financial statements related to accounting estimates are in accordance with the requirements of the applicable financial reporting framework. (Ref: Para. A120-A121)

20. For accounting estimates that give rise to significant risks, the auditor shall also evaluate the adequacy of the disclosure of their estimation uncertainty in the financial statements in the context of the applicable financial reporting framework. (Ref: Para. A122-A123)

Indicators of Possible Management Bias

21. The auditor shall review the judgments and decisions made by management in the making of accounting estimates to identify whether there are indicators of possible management bias. Indicators of possible management bias do not themselves constitute misstatements for the purposes of drawing conclusions on the reasonableness of individual accounting estimates. (Ref: Para. A124-A125)

Written Representations

22. The auditor shall obtain written representations from management and, where appropriate, those charged with governance whether they believe significant assumptions used in making accounting estimates are reasonable. (Ref: Para. A126-A127)

Documentation

23. The auditor shall include in the audit documentation:[8]

    (a) The basis for the auditor's conclusions about the reasonableness of accounting estimates and their disclosure that give rise to significant risks; and

    (b) Indicators of possible management bias, if any. (Ref: Para. A128)

Conformity and Compliance with International Standards on Auditing

24. As of July 2009 (date of issue), this HKSA conforms with International Standard on Auditing (ISA) 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures". Compliance with the requirements of this HKSA ensures compliance with ISA 540.

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Application and Other Explanatory Material

Nature of Accounting Estimates (Ref: Para. 2)

A1. Because of the uncertainties inherent in business activities, some financial statement items can only be estimated. Further, the specific characteristics of an asset, liability or component of equity, or the basis of or method of measurement prescribed by the financial reporting framework, may give rise to the need to estimate a financial statement item. Some financial reporting frameworks prescribe specific methods of measurement and the disclosures that are required to be made in the financial statements, while other financial reporting frameworks are less specific. The Appendix to this HKSA discusses fair value measurements and disclosures under different financial reporting frameworks.

A2. Some accounting estimates involve relatively low estimation uncertainty and may give rise to lower risks of material misstatements, for example:

- Accounting estimates arising in entities that engage in business activities that are not complex.

- Accounting estimates that are frequently made and updated because they relate to routine transactions.

- Accounting estimates derived from data that is readily available, such as published interest rate data or exchange-traded prices of securities. Such data may be referred to as "observable" in the context of a fair value accounting estimate.

- Fair value accounting estimates where the method of measurement prescribed by the applicable financial reporting framework is simple and applied easily to the asset or liability requiring measurement at fair value.

- Fair value accounting estimates where the model used to measure the accounting estimate is well-known or generally accepted, provided that the assumptions or inputs to the model are observable.

[8] HKSA 230, "Audit Documentation," paragraphs 8-11, and A6.

A3. For some accounting estimates, however, there may be relatively high estimation uncertainty, particularly where they are based on significant assumptions, for example:

- Accounting estimates relating to the outcome of litigation.
- Fair value accounting estimates for derivative financial instruments not publicly traded.
- Fair value accounting estimates for which a highly specialized entity-developed model is used or for which there are assumptions or inputs that cannot be observed in the marketplace.

A4. The degree of estimation uncertainty varies based on the nature of the accounting estimate, the extent to which there is a generally accepted method or model used to make the accounting estimate, and the subjectivity of the assumptions used to make the accounting estimate. In some cases, estimation uncertainty associated with an accounting estimate may be so great that the recognition criteria in the applicable financial reporting framework are not met and the accounting estimate cannot be made.

A5. Not all financial statement items requiring measurement at fair value involve estimation uncertainty. For example, this may be the case for some financial statement items where there is an active and open market that provides readily available and reliable information on the prices at which actual exchanges occur, in which case the existence of published price quotations ordinarily is the best audit evidence of fair value. However, estimation uncertainty may exist even when the valuation method and data are well defined. For example, valuation of securities quoted on an active and open market at the listed market price may require adjustment if the holding is significant in relation to the market or is subject to restrictions in marketability. In addition, general economic circumstances prevailing at the time, for example, illiquidity in a particular market, may impact estimation uncertainty.

A6. Additional examples of situations where accounting estimates, other than fair value accounting estimates, may be required include:

- Allowance for doubtful accounts.
- Inventory obsolescence.
- Warranty obligations.
- Depreciation method or asset useful life.
- Provision against the carrying amount of an investment where there is uncertainty regarding its recoverability.
- Outcome of long term contracts.
- Costs arising from litigation settlements and judgments.

A7. Additional examples of situations where fair value accounting estimates may be required include:

- Complex financial instruments, which are not traded in an active and open market.
- Share-based payments.
- Property or equipment held for disposal.

- Certain assets or liabilities acquired in a business combination, including goodwill and intangible assets.

- Transactions involving the exchange of assets or liabilities between independent parties without monetary consideration, for example, a non-monetary exchange of plant facilities in different lines of business.

A8. Estimation involves judgments based on information available when the financial statements are prepared. For many accounting estimates, these include making assumptions about matters that are uncertain at the time of estimation. The auditor is not responsible for predicting future conditions, transactions or events that, if known at the time of the audit, might have significantly affected management's actions or the assumptions used by management.

Management Bias

A9. Financial reporting frameworks often call for neutrality, that is, freedom from bias. Accounting estimates are imprecise, however, and can be influenced by management judgment. Such judgment may involve unintentional or intentional management bias (for example, as a result of motivation to achieve a desired result). The susceptibility of an accounting estimate to management bias increases with the subjectivity involved in making it. Unintentional management bias and the potential for intentional management bias are inherent in subjective decisions that are often required in making an accounting estimate. For continuing audits, indicators of possible management bias identified during the audit of the preceding periods influence the planning and risk identification and assessment activities of the auditor in the current period.

A10. Management bias can be difficult to detect at an account level. It may only be identified when considered in the aggregate of groups of accounting estimates or all accounting estimates, or when observed over a number of accounting periods. Although some form of management bias is inherent in subjective decisions, in making such judgments there may be no intention by management to mislead the users of financial statements. Where, however, there is intention to mislead, management bias is fraudulent in nature.

Considerations Specific to Public Sector Entities

A11. Public sector entities may have significant holdings of specialized assets for which there are no readily available and reliable sources of information for purposes of measurement at fair value or other current value bases, or a combination of both. Often specialized assets held do not generate cash flows and do not have an active market. Measurement at fair value therefore ordinarily requires estimation and may be complex, and in some rare cases may not be possible at all.

Risk Assessment Procedures and Related Activities (Ref: Para. 8)

A12. The risk assessment procedures and related activities required by paragraph 8 of this HKSA assist the auditor in developing an expectation of the nature and type of accounting estimates that an entity may have. The auditor's primary consideration is whether the understanding that has been obtained is sufficient to identify and assess the risks of material misstatement in relation to accounting estimates, and to plan the nature, timing and extent of further audit procedures.

Obtaining an Understanding of the Requirements of the Applicable Financial Reporting Framework (Ref: Para. 8(a))

A13. Obtaining an understanding of the requirements of the applicable financial reporting framework assists the auditor in determining whether it, for example:

- Prescribes certain conditions for the recognition,[9] or methods for the measurement, of accounting estimates.
- Specifies certain conditions that permit or require measurement at a fair value, for example, by referring to management's intentions to carry out certain courses of action with respect to an asset or liability.
- Specifies required or permitted disclosures.

Obtaining this understanding also provides the auditor with a basis for discussion with management about how management has applied those requirements relevant to the accounting estimate, and the auditor's determination of whether they have been applied appropriately.

A14. Financial reporting frameworks may provide guidance for management on determining point estimates where alternatives exist. Some financial reporting frameworks, for example, require that the point estimate selected be the alternative that reflects management's judgment of the most likely outcome.[10] Others may require, for example, use of a discounted probability-weighted expected value. In some cases, management may be able to make a point estimate directly. In other cases, management may be able to make a reliable point estimate only after considering alternative assumptions or outcomes from which it is able to determine a point estimate.

A15. Financial reporting frameworks may require the disclosure of information concerning the significant assumptions to which the accounting estimate is particularly sensitive. Furthermore, where there is a high degree of estimation uncertainty, some financial reporting frameworks do not permit an accounting estimate to be recognized in the financial statements, but certain disclosures may be required in the notes to the financial statements.

Obtaining an Understanding of How Management Identifies the Need for Accounting Estimates (Ref: Para. 8(b))

A16. The preparation of the financial statements requires management to determine whether a transaction, event or condition gives rise to the need to make an accounting estimate, and that all necessary accounting estimates have been recognized, measured and disclosed in the financial statements in accordance with the applicable financial reporting framework.

A17. Management's identification of transactions, events and conditions that give rise to the need for accounting estimates is likely to be based on:

- Management's knowledge of the entity's business and the industry in which it operates.
- Management's knowledge of the implementation of business strategies in the current period.

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9 Most financial reporting frameworks require incorporation in the balance sheet or income statement of items that satisfy their criteria for recognition. Disclosure of accounting policies or adding notes to the financial statements does not rectify a failure to recognize such items, including accounting estimates.

10 Different financial reporting frameworks may use different terminology to describe point estimates determined in this way.

- Where applicable, management's cumulative experience of preparing the entity's financial statements in prior periods.

In such cases, the auditor may obtain an understanding of how management identifies the need for accounting estimates primarily through inquiry of management. In other cases, where management's process is more structured, for example, when management has a formal risk management function, the auditor may perform risk assessment procedures directed at the methods and practices followed by management for periodically reviewing the circumstances that give rise to the accounting estimates and re-estimating the accounting estimates as necessary. The completeness of accounting estimates is often an important consideration of the auditor, particularly accounting estimates relating to liabilities.

A18. The auditor's understanding of the entity and its environment obtained during the performance of risk assessment procedures, together with other audit evidence obtained during the course of the audit, assist the auditor in identifying circumstances, or changes in circumstances, that may give rise to the need for an accounting estimate.

A19. Inquiries of management about changes in circumstances may include, for example, inquiries about whether:

- The entity has engaged in new types of transactions that may give rise to accounting estimates.
- Terms of transactions that gave rise to accounting estimates have changed.
- Accounting policies relating to accounting estimates have changed, as a result of changes to the requirements of the applicable financial reporting framework or otherwise.
- Regulatory or other changes outside the control of management have occurred that may require management to revise, or make new, accounting estimates.
- New conditions or events have occurred that may give rise to the need for new or revised accounting estimates.

A20. During the audit, the auditor may identify transactions, events and conditions that give rise to the need for accounting estimates that management failed to identify. HKSA 315 deals with circumstances where the auditor identifies risks of material misstatement that management failed to identify, including determining whether there is a significant deficiency in internal control with regard to the entity's risk assessment processes.[11]

Considerations Specific to Smaller Entities

A21. Obtaining this understanding for smaller entities is often less complex as their business activities are often limited and transactions are less complex. Further, often a single person, for example the owner-manager, identifies the need to make an accounting estimate and the auditor may focus inquiries accordingly.

Obtaining an Understanding of How Management Makes the Accounting Estimates (Ref: Para. 8(c))

A22. The preparation of the financial statements also requires management to establish financial reporting processes for making accounting estimates, including adequate internal control. Such processes include the following:

[11] HKSA 315, paragraph 16.

- Selecting appropriate accounting policies and prescribing estimation processes, including appropriate estimation or valuation methods, including, where applicable, models.

- Developing or identifying relevant data and assumptions that affect accounting estimates.

- Periodically reviewing the circumstances that give rise to the accounting estimates and re-estimating the accounting estimates as necessary.

A23. Matters that the auditor may consider in obtaining an understanding of how management makes the accounting estimates include, for example:

- The types of accounts or transactions to which the accounting estimates relate (for example, whether the accounting estimates arise from the recording of routine and recurring transactions or whether they arise from non-recurring or unusual transactions).

- Whether and, if so, how management has used recognized measurement techniques for making particular accounting estimates.

- Whether the accounting estimates were made based on data available at an interim date and, if so, whether and how management has taken into account the effect of events, transactions and changes in circumstances occurring between that date and the period end.

Method of Measurement, Including the Use of Models (Ref: Para. 8(c)(i))

A24. In some cases, the applicable financial reporting framework may prescribe the method of measurement for an accounting estimate, for example, a particular model that is to be used in measuring a fair value estimate. In many cases, however, the applicable financial reporting framework does not prescribe the method of measurement, or may specify alternative methods for measurement.

A25. When the applicable financial reporting framework does not prescribe a particular method to be used in the circumstances, matters that the auditor may consider in obtaining an understanding of the method or, where applicable the model, used to make accounting estimates include, for example:

- How management considered the nature of the asset or liability being estimated when selecting a particular method.

- Whether the entity operates in a particular business, industry or environment in which there are methods commonly used to make the particular type of accounting estimate.

A26. There may be greater risks of material misstatement, for example, in cases when management has internally developed a model to be used to make the accounting estimate or is departing from a method commonly used in a particular industry or environment.

Relevant Controls (Ref: Para. 8(c)(ii))

A27. Matters that the auditor may consider in obtaining an understanding of relevant controls include, for example, the experience and competence of those who make the accounting estimates, and controls related to:

- How management determines the completeness, relevance and accuracy of the data used to develop accounting estimates.

- The review and approval of accounting estimates, including the assumptions or inputs used in their development, by appropriate levels of management and, where appropriate, those charged with governance.

- The segregation of duties between those committing the entity to the underlying transactions and those responsible for making the accounting estimates, including whether the assignment of responsibilities appropriately takes account of the nature of the entity and its products or services (for example, in the case of a large financial institution, relevant segregation of duties may include an independent function responsible for estimation and validation of fair value pricing of the entity's proprietary financial products staffed by individuals whose remuneration is not tied to such products).

A28. Other controls may be relevant to making the accounting estimates depending on the circumstances. For example, if the entity uses specific models for making accounting estimates, management may put into place specific policies and procedures around such models. Relevant controls may include, for example, those established over:

- The design and development, or selection, of a particular model for a particular purpose.

- The use of the model.

- The maintenance and periodic validation of the integrity of the model.

Management's Use of Experts (Ref: Para. 8(c)(iii))

A29. Management may have, or the entity may employ individuals with, the experience and competence necessary to make the required point estimates. In some cases, however, management may need to engage an expert to make, or assist in making, them. This need may arise because of, for example:

- The specialized nature of the matter requiring estimation, for example, the measurement of mineral or hydrocarbon reserves in extractive industries.

- The technical nature of the models required to meet the relevant requirements of the applicable financial reporting framework, as may be the case in certain measurements at fair value.

- The unusual or infrequent nature of the condition, transaction or event requiring an accounting estimate.

Considerations specific to smaller entities

A30. In smaller entities, the circumstances requiring an accounting estimate often are such that the owner-manager is capable of making the required point estimate. In some cases, however, an expert will be needed. Discussion with the owner-manager early in the audit process about the nature of any accounting estimates, the completeness of the required accounting estimates, and the adequacy of the estimating process may assist the owner-manager in determining the need to use an expert.

Assumptions (Ref: Para. 8(c)(iv))

A31. Assumptions are integral components of accounting estimates. Matters that the auditor may consider in obtaining an understanding of the assumptions underlying the accounting estimates include, for example:

- The nature of the assumptions, including which of the assumptions are likely to be significant assumptions.

- How management assesses whether the assumptions are relevant and complete (that is, that all relevant variables have been taken into account).

- Where applicable, how management determines that the assumptions used are internally consistent.

- Whether the assumptions relate to matters within the control of management (for example, assumptions about the maintenance programs that may affect the estimation of an asset's useful life), and how they conform to the entity's business plans and the external environment, or to matters that are outside its control (for example, assumptions about interest rates, mortality rates, potential judicial or regulatory actions, or the variability and the timing of future cash flows).

- The nature and extent of documentation, if any, supporting the assumptions.

Assumptions may be made or identified by an expert to assist management in making the accounting estimates. Such assumptions, when used by management, become management's assumptions.

A32. In some cases, assumptions may be referred to as inputs, for example, where management uses a model to make an accounting estimate, though the term inputs may also be used to refer to the underlying data to which specific assumptions are applied.

A33. Management may support assumptions with different types of information drawn from internal and external sources, the relevance and reliability of which will vary. In some cases, an assumption may be reliably based on applicable information from either external sources (for example, published interest rate or other statistical data) or internal sources (for example, historical information or previous conditions experienced by the entity). In other cases, an assumption may be more subjective, for example, where the entity has no experience or external sources from which to draw.

A34. In the case of fair value accounting estimates, assumptions reflect, or are consistent with, what knowledgeable, willing arm's length parties (sometimes referred to as "marketplace participants" or equivalent) would use in determining fair value when exchanging an asset or settling a liability. Specific assumptions will also vary with the characteristics of the asset or liability being valued, the valuation method used (for example, a market approach, or an income approach) and the requirements of the applicable financial reporting framework.

A35. With respect to fair value accounting estimates, assumptions or inputs vary in terms of their source and bases, as follows:

(a) Those that reflect what marketplace participants would use in pricing an asset or liability developed based on market data obtained from sources independent of the reporting entity (sometimes referred to as "observable inputs" or equivalent).

(b) Those that reflect the entity's own judgments about what assumptions marketplace participants would use in pricing the asset or liability developed based on the best information available in the circumstances (sometimes referred to as "unobservable inputs" or equivalent).

In practice, however, the distinction between (a) and (b) is not always apparent. Further, it may be necessary for management to select from a number of different assumptions used by different marketplace participants.

A36. The extent of subjectivity, such as whether an assumption or input is observable, influences the degree of estimation uncertainty and thereby the auditor's assessment of the risks of material misstatement for a particular accounting estimate.

Changes in Methods for Making Accounting Estimates (Ref: Para. 8(c)(v))

A37. In evaluating how management makes the accounting estimates, the auditor is required to understand whether there has been or ought to have been a change from the prior period in the methods for making the accounting estimates. A specific estimation method may need to be changed in response to changes in the environment or circumstances affecting the entity or in the requirements of the applicable financial reporting framework. If management has changed the method for making an accounting estimate, it is important that management can demonstrate that the new method is more appropriate, or is itself a response to such changes. For example, if management changes the basis of making an accounting estimate from a mark-to-market approach to using a model, the auditor challenges whether management's assumptions about the marketplace are reasonable in light of economic circumstances.

Estimation Uncertainty (Ref: Para. 8(c)(vi))

A38. Matters that the auditor may consider in obtaining an understanding of whether and, if so, how management has assessed the effect of estimation uncertainty include, for example:

- Whether and, if so, how management has considered alternative assumptions or outcomes by, for example, performing a sensitivity analysis to determine the effect of changes in the assumptions on an accounting estimate.

- How management determines the accounting estimate when analysis indicates a number of outcome scenarios.

- Whether management monitors the outcome of accounting estimates made in the prior period, and whether management has appropriately responded to the outcome of that monitoring procedure.

Reviewing Prior Period Accounting Estimates (Ref: Para. 9)

A39. The outcome of an accounting estimate will often differ from the accounting estimate recognized in the prior period financial statements. By performing risk assessment procedures to identify and understand the reasons for such differences, the auditor may obtain:

- Information regarding the effectiveness of management's prior period estimation process, from which the auditor can judge the likely effectiveness of management's current process.

- Audit evidence that is pertinent to the re-estimation, in the current period, of prior period accounting estimates.

- Audit evidence of matters, such as estimation uncertainty, that may be required to be disclosed in the financial statements.

A40. The review of prior period accounting estimates may also assist the auditor, in the current period, in identifying circumstances or conditions that increase the susceptibility of accounting estimates to, or indicate the presence of, possible management bias. The auditor's professional skepticism assists in identifying such circumstances or conditions and in determining the nature, timing and extent of further audit procedures.

A41. A retrospective review of management judgments and assumptions related to significant accounting estimates is also required by HKSA 240.[12] That review is conducted as part of the requirement for the auditor to design and perform procedures to review accounting estimates for biases that could represent a risk of material misstatement due to fraud, in response to the risks of management override of controls. As a practical matter, the auditor's review of prior period accounting estimates as a risk assessment procedure in accordance with this HKSA may be carried out in conjunction with the review required by HKSA 240.

A42. The auditor may judge that a more detailed review is required for those accounting estimates that were identified during the prior period audit as having high estimation uncertainty, or for those accounting estimates that have changed significantly from the prior period. On the other hand, for example, for accounting estimates that arise from the recording of routine and recurring transactions, the auditor may judge that the application of analytical procedures as risk assessment procedures is sufficient for purposes of the review.

A43. For fair value accounting estimates and other accounting estimates based on current conditions at the measurement date, more variation may exist between the fair value amount recognized in the prior period financial statements and the outcome or the amount re-estimated for the purpose of the current period. This is because the measurement objective for such accounting estimates deals with perceptions about value at a point in time, which may change significantly and rapidly as the environment in which the entity operates changes. The auditor may therefore focus the review on obtaining information that would be relevant to identifying and assessing risks of material misstatement. For example, in some cases, obtaining an understanding of changes in marketplace participant assumptions which affected the outcome of a prior period fair value accounting estimate may be unlikely to provide relevant information for audit purposes. If so, then the auditor's consideration of the outcome of prior period fair value accounting estimates may be directed more towards understanding the effectiveness of management's prior estimation process, that is, management's track record, from which the auditor can judge the likely effectiveness of management's current process.

A44. A difference between the outcome of an accounting estimate and the amount recognized in the prior period financial statements does not necessarily represent a misstatement of the prior period financial statements. However, it may do so if, for example, the difference arises from information that was available to management when the prior period's financial statements were finalized, or that could reasonably be expected to have been obtained and taken into account in the preparation of those financial statements. Many financial reporting frameworks contain guidance on distinguishing between changes in accounting estimates that constitute misstatements and changes that do not, and the accounting treatment required to be followed.

Identifying and Assessing the Risks of Material Misstatement

Estimation Uncertainty (Ref: Para. 10)

A45. The degree of estimation uncertainty associated with an accounting estimate may be influenced by factors such as:

- The extent to which the accounting estimate depends on judgment.
- The sensitivity of the accounting estimate to changes in assumptions.

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12 HKSA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements," paragraph 32(b)(ii).

- The existence of recognized measurement techniques that may mitigate the estimation uncertainty (though the subjectivity of the assumptions used as inputs may nevertheless give rise to estimation uncertainty).

- The length of the forecast period, and the relevance of data drawn from past events to forecast future events.

- The availability of reliable data from external sources.

- The extent to which the accounting estimate is based on observable or unobservable inputs.

The degree of estimation uncertainty associated with an accounting estimate may influence the estimate's susceptibility to bias.

A46. Matters that the auditor considers in assessing the risks of material misstatement may also include:

- The actual or expected magnitude of an accounting estimate.

- The recorded amount of the accounting estimate (that is, management's point estimate) in relation to the amount expected by the auditor to be recorded.

- Whether management has used an expert in making the accounting estimate.

- The outcome of the review of prior period accounting estimates.

High Estimation Uncertainty and Significant Risks (Ref: Para. 11)

A47. Examples of accounting estimates that may have high estimation uncertainty include the following:

- Accounting estimates that are highly dependent upon judgment, for example, judgments about the outcome of pending litigation or the amount and timing of future cash flows dependent on uncertain events many years in the future.

- Accounting estimates that are not calculated using recognized measurement techniques.

- Accounting estimates where the results of the auditor's review of similar accounting estimates made in the prior period financial statements indicate a substantial difference between the original accounting estimate and the actual outcome.

- Fair value accounting estimates for which a highly specialized entity-developed model is used or for which there are no observable inputs.

A48. A seemingly immaterial accounting estimate may have the potential to result in a material misstatement due to the estimation uncertainty associated with the estimation; that is, the size of the amount recognized or disclosed in the financial statements for an accounting estimate may not be an indicator of its estimation uncertainty.

A49. In some circumstances, the estimation uncertainty is so high that a reasonable accounting estimate cannot be made. The applicable financial reporting framework may, therefore, preclude recognition of the item in the financial statements, or its measurement at fair value. In such cases, the significant risks relate not only to whether an accounting estimate should be recognized, or whether it should be measured at fair value, but also to the adequacy of the disclosures. With respect to such accounting estimates, the applicable financial reporting framework may require disclosure of the accounting estimates and the high estimation uncertainty associated with them (see paragraphs A120-A123).

A50. If the auditor determines that an accounting estimate gives rise to a significant risk, the auditor is required to obtain an understanding of the entity's controls, including control activities.[13]

A51. In some cases, the estimation uncertainty of an accounting estimate may cast significant doubt about the entity's ability to continue as a going concern. HKSA 570 [14] establishes requirements and provides guidance in such circumstances.

Responses to the Assessed Risks of Material Misstatement (Ref: Para. 12)

A52. HKSA 330 requires the auditor to design and perform audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement in relation to accounting estimates at both the financial statement and assertion levels.[15] Paragraphs A53-A115 focus on specific responses at the assertion level only.

Application of the Requirements of the Applicable Financial Reporting Framework (Ref: Para. 12(a))

A53. Many financial reporting frameworks prescribe certain conditions for the recognition of accounting estimates and specify the methods for making them and required disclosures. Such requirements may be complex and require the application of judgment. Based on the understanding obtained in performing risk assessment procedures, the requirements of the applicable financial reporting framework that may be susceptible to misapplication or differing interpretations become the focus of the auditor's attention.

A54. Determining whether management has appropriately applied the requirements of the applicable financial reporting framework is based, in part, on the auditor's understanding of the entity and its environment. For example, the measurement of the fair value of some items, such as intangible assets acquired in a business combination, may involve special considerations that are affected by the nature of the entity and its operations.

A55. In some situations, additional audit procedures, such as the inspection by the auditor of the current physical condition of an asset, may be necessary to determine whether management has appropriately applied the requirements of the applicable financial reporting framework.

A56. The application of the requirements of the applicable financial reporting framework requires management to consider changes in the environment or circumstances that affect the entity. For example, the introduction of an active market for a particular class of asset or liability may indicate that the use of discounted cash flows to estimate the fair value of such asset or liability is no longer appropriate.

Consistency in Methods and Basis for Changes (Ref: Para. 12(b))

A57. The auditor's consideration of a change in an accounting estimate, or in the method for making it from the prior period, is important because a change that is not based on a change in circumstances or new information is considered arbitrary. Arbitrary changes in an accounting estimate result in inconsistent financial statements over time and may give rise to a financial statement misstatement or be an indicator of possible management bias.

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[13] HKSA 315, paragraph 29.

[14] HKSA 570, "Going Concern."

[15] HKSA 330, paragraphs 5-6.

A58. Management often is able to demonstrate good reason for a change in an accounting estimate or the method for making an accounting estimate from one period to another based on a change in circumstances. What constitutes a good reason, and the adequacy of support for management's contention that there has been a change in circumstances that warrants a change in an accounting estimate or the method for making an accounting estimate, are matters of judgment.

Responses to the Assessed Risks of Material Misstatements (Ref: Para. 13)

A59. The auditor's decision as to which response, individually or in combination, in paragraph 13 to undertake to respond to the risks of material misstatement may be influenced by such matters as:

- The nature of the accounting estimate, including whether it arises from routine or non routine transactions.
- Whether the procedure(s) is expected to effectively provide the auditor with sufficient appropriate audit evidence.
- The assessed risk of material misstatement, including whether the assessed risk is a significant risk.

A60. For example, when evaluating the reasonableness of the allowance for doubtful accounts, an effective procedure for the auditor may be to review subsequent cash collections in combination with other procedures. Where the estimation uncertainty associated with an accounting estimate is high, for example, an accounting estimate based on a proprietary model for which there are unobservable inputs, it may be that a combination of the responses to assessed risks in paragraph 13 is necessary in order to obtain sufficient appropriate audit evidence.

A61. Additional guidance explaining the circumstances in which each of the responses may be appropriate is provided in paragraphs A62-A95.

Events Occurring Up to the Date of the Auditor's Report (Ref: Para. 13(a))

A62. Determining whether events occurring up to the date of the auditor's report provide audit evidence regarding the accounting estimate may be an appropriate response when such events are expected to:

- Occur; and
- Provide audit evidence that confirms or contradicts the accounting estimate.

A63. Events occurring up to the date of the auditor's report may sometimes provide sufficient appropriate audit evidence about an accounting estimate. For example, sale of the complete inventory of a superseded product shortly after the period end may provide audit evidence relating to the estimate of its net realizable value. In such cases, there may be no need to perform additional audit procedures on the accounting estimate, provided that sufficient appropriate evidence about the events is obtained.

A64. For some accounting estimates, events occurring up to the date of the auditor's report are unlikely to provide audit evidence regarding the accounting estimate. For example, the conditions or events relating to some accounting estimates develop only over an extended period. Also, because of the measurement objective of fair value accounting estimates, information after the period end may not reflect the events or conditions existing at the balance sheet date and therefore may not be relevant to the measurement of the fair value accounting estimate. Paragraph 13 identifies other responses to the risks of material misstatement that the auditor may undertake.

A65. In some cases, events that contradict the accounting estimate may indicate that management has ineffective processes for making accounting estimates, or that there is management bias in the making of accounting estimates.

A66. Even though the auditor may decide not to undertake this approach in respect of specific accounting estimates, the auditor is required to comply with HKSA 560.[16] The auditor is required to perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified [17] and appropriately reflected in the financial statements.[18] Because the measurement of many accounting estimates, other than fair value accounting estimates, usually depends on the outcome of future conditions, transactions or events, the auditor's work under HKSA 560 is particularly relevant.

Considerations specific to smaller entities

A67. When there is a longer period between the balance sheet date and the date of the auditor's report, the auditor's review of events in this period may be an effective response for accounting estimates other than fair value accounting estimates. This may particularly be the case in some smaller owner-managed entities, especially when management does not have formalized control procedures over accounting estimates.

Testing How Management Made the Accounting Estimate (Ref: Para. 13(b))

A68. Testing how management made the accounting estimate and the data on which it is based may be an appropriate response when the accounting estimate is a fair value accounting estimate developed on a model that uses observable and unobservable inputs. It may also be appropriate when, for example:

- The accounting estimate is derived from the routine processing of data by the entity's accounting system.
- The auditor's review of similar accounting estimates made in the prior period financial statements suggests that management's current period process is likely to be effective.
- The accounting estimate is based on a large population of items of a similar nature that individually are not significant.

A69. Testing how management made the accounting estimate may involve, for example:

- Testing the extent to which data on which the accounting estimate is based is accurate, complete and relevant, and whether the accounting estimate has been properly determined using such data and management assumptions.
- Considering the source, relevance and reliability of external data or information, including that received from external experts engaged by management to assist in making an accounting estimate.
- Recalculating the accounting estimate, and reviewing information about an accounting estimate for internal consistency.

[16] HKSA 560, "Subsequent Events."

[17] HKSA 560, paragraph 6.

[18] HKSA 560, paragraph 8.

- Considering management's review and approval processes.

Considerations specific to smaller entities

A70. In smaller entities, the process for making accounting estimates is likely to be less structured than in larger entities. Smaller entities with active management involvement may not have extensive descriptions of accounting procedures, sophisticated accounting records, or written policies. Even if the entity has no formal established process, it does not mean that management is not able to provide a basis upon which the auditor can test the accounting estimate.

Evaluating the method of measurement (Ref: Para. 13(b)(i))

A71. When the applicable financial reporting framework does not prescribe the method of measurement, evaluating whether the method used, including any applicable model, is appropriate in the circumstances is a matter of professional judgment.

A72. For this purpose, matters that the auditor may consider include, for example, whether:

- Management's rationale for the method selected is reasonable.
- Management has sufficiently evaluated and appropriately applied the criteria, if any, provided in the applicable financial reporting framework to support the selected method.
- The method is appropriate in the circumstances given the nature of the asset or liability being estimated and the requirements of the applicable financial reporting framework relevant to accounting estimates.
- The method is appropriate in relation to the business, industry and environment in which the entity operates.

A73. In some cases, management may have determined that different methods result in a range of significantly different estimates. In such cases, obtaining an understanding of how the entity has investigated the reasons for these differences may assist the auditor in evaluating the appropriateness of the method selected.

Evaluating the use of models

A74. In some cases, particularly when making fair value accounting estimates, management may use a model. Whether the model used is appropriate in the circumstances may depend on a number of factors, such as the nature of the entity and its environment, including the industry in which it operates, and the specific asset or liability being measured.

A75. The extent to which the following considerations are relevant depends on the circumstances, including whether the model is one that is commercially available for use in a particular sector or industry, or a proprietary model. In some cases, an entity may use an expert to develop and test a model.

A76. Depending on the circumstances, matters that the auditor may also consider in testing the model include, for example, whether:

- The model is validated prior to usage, with periodic reviews to ensure it is still suitable for its intended use. The entity's validation process may include evaluation of:
  - The model's theoretical soundness and mathematical integrity, including the appropriateness of model parameters.

  - The consistency and completeness of the model's inputs with market practices.
  - The model's output as compared to actual transactions.

- Appropriate change control policies and procedures exist.
- The model is periodically calibrated and tested for validity, particularly when inputs are subjective.
- Adjustments are made to the output of the model, including in the case of fair value accounting estimates, whether such adjustments reflect the assumptions marketplace participants would use in similar circumstances.
- The model is adequately documented, including the model's intended applications and limitations and its key parameters, required inputs, and results of any validation analysis performed.

Assumptions used by management (Ref: Para. 13(b)(ii))

A77. The auditor's evaluation of the assumptions used by management is based only on information available to the auditor at the time of the audit. Audit procedures dealing with management assumptions are performed in the context of the audit of the entity's financial statements, and not for the purpose of providing an opinion on assumptions themselves.

A78. Matters that the auditor may consider in evaluating the reasonableness of the assumptions used by management include, for example:

- Whether individual assumptions appear reasonable.
- Whether the assumptions are interdependent and internally consistent.
- Whether the assumptions appear reasonable when considered collectively or in conjunction with other assumptions, either for that accounting estimate or for other accounting estimates.
- In the case of fair value accounting estimates, whether the assumptions appropriately reflect observable marketplace assumptions.

A79. The assumptions on which accounting estimates are based may reflect what management expects will be the outcome of specific objectives and strategies. In such cases, the auditor may perform audit procedures to evaluate the reasonableness of such assumptions by considering, for example, whether the assumptions are consistent with:

- The general economic environment and the entity's economic circumstances.
- The plans of the entity.
- Assumptions made in prior periods, if relevant.
- Experience of, or previous conditions experienced by, the entity, to the extent this historical information may be considered representative of future conditions or events.
- Other assumptions used by management relating to the financial statements.

A80. The reasonableness of the assumptions used may depend on management's intent and ability to carry out certain courses of action. Management often documents plans and intentions relevant to specific assets or liabilities and the financial reporting framework may require it to do so. Although the extent of audit evidence to be obtained about management's intent and ability is a matter of professional judgment, the auditor's procedures may include the following:

- Review of management's history of carrying out its stated intentions.
- Review of written plans and other documentation, including, where applicable, formally approved budgets, authorizations or minutes.
- Inquiry of management about its reasons for a particular course of action.
- Review of events occurring subsequent to the date of the financial statements and up to the date of the auditor's report.
- Evaluation of the entity's ability to carry out a particular course of action given the entity's economic circumstances, including the implications of its existing commitments.

Certain financial reporting frameworks, however, may not permit management's intentions or plans to be taken into account when making an accounting estimate. This is often the case for fair value accounting estimates because their measurement objective requires that assumptions reflect those used by marketplace participants.

A81. Matters that the auditor may consider in evaluating the reasonableness of assumptions used by management underlying fair value accounting estimates, in addition to those discussed above, where applicable, may include, for example:

- Where relevant, whether and, if so, how management has incorporated market-specific inputs into the development of assumptions.
- Whether the assumptions are consistent with observable market conditions, and the characteristics of the asset or liability being measured at fair value.
- Whether the sources of market-participant assumptions are relevant and reliable, and how management has selected the assumptions to use when a number of different market participant assumptions exist.
- Where appropriate, whether and, if so, how management considered assumptions used in, or information about, comparable transactions, assets or liabilities.

A82. Further, fair value accounting estimates may comprise observable inputs as well as unobservable inputs. Where fair value accounting estimates are based on unobservable inputs, matters that the auditor may consider include, for example, how management supports the following:

- The identification of the characteristics of marketplace participants relevant to the accounting estimate.
- Modifications it has made to its own assumptions to reflect its view of assumptions marketplace participants would use.
- Whether it has incorporated the best information available in the circumstances.

- Where applicable, how its assumptions take account of comparable transactions, assets or liabilities.

If there are unobservable inputs, it is more likely that the auditor's evaluation of the assumptions will need to be combined with other responses to assessed risks in paragraph 13 in order to obtain sufficient appropriate audit evidence. In such cases, it may be necessary for the auditor to perform other audit procedures, for example, examining documentation supporting the review and approval of the accounting estimate by appropriate levels of management and, where appropriate, by those charged with governance.

A83. In evaluating the reasonableness of the assumptions supporting an accounting estimate, the auditor may identify one or more significant assumptions. If so, it may indicate that the accounting estimate has high estimation uncertainty and may, therefore, give rise to a significant risk. Additional responses to significant risks are described in paragraphs A102-A115.

Testing the Operating Effectiveness of Controls (Ref: Para. 13(c))

A84. Testing the operating effectiveness of the controls over how management made the accounting estimate may be an appropriate response when management's process has been well-designed, implemented and maintained, for example:

- Controls exist for the review and approval of the accounting estimates by appropriate levels of management and, where appropriate, by those charged with governance.

- The accounting estimate is derived from the routine processing of data by the entity's accounting system.

A85. Testing the operating effectiveness of the controls is required when:

(a) The auditor's assessment of risks of material misstatement at the assertion level includes an expectation that controls over the process are operating effectively; or

(b) Substantive procedures alone do not provide sufficient appropriate audit evidence at the assertion level.[19]

Considerations specific to smaller entities

A86. Controls over the process to make an accounting estimate may exist in smaller entities, but the formality with which they operate varies. Further, smaller entities may determine that certain types of controls are not necessary because of active management involvement in the financial reporting process. In the case of very small entities, however, there may not be many controls that the auditor can identify. For this reason, the auditor's response to the assessed risks is likely to be substantive in nature, with the auditor performing one or more of the other responses in paragraph 13.

Developing a Point Estimate or Range (Ref: Para. 13(d))

A87. Developing a point estimate or a range to evaluate management's point estimate may be an appropriate response where, for example:

- An accounting estimate is not derived from the routine processing of data by the accounting system.

[19] HKSA 330, paragraph 8.

- The auditor's review of similar accounting estimates made in the prior period financial statements suggests that management's current period process is unlikely to be effective.

- The entity's controls within and over management's processes for determining accounting estimates are not well designed or properly implemented.

- Events or transactions between the period end and the date of the auditor's report contradict management's point estimate.

- There are alternative sources of relevant data available to the auditor which can be used in developing a point estimate or a range.

A88. Even where the entity's controls are well designed and properly implemented, developing a point estimate or a range may be an effective or efficient response to the assessed risks. In other situations, the auditor may consider this approach as part of determining whether further procedures are necessary and, if so, their nature and extent.

A89. The approach taken by the auditor in developing either a point estimate or a range may vary based on what is considered most effective in the circumstances. For example, the auditor may initially develop a preliminary point estimate, and then assess its sensitivity to changes in assumptions to ascertain a range with which to evaluate management's point estimate. Alternatively, the auditor may begin by developing a range for purposes of determining, where possible, a point estimate.

A90. The ability of the auditor to develop a point estimate, as opposed to a range, depends on several factors, including the model used, the nature and extent of data available and the estimation uncertainty involved with the accounting estimate. Further, the decision to develop a point estimate or range may be influenced by the applicable financial reporting framework, which may prescribe the point estimate that is to be used after consideration of the alternative outcomes and assumptions, or prescribe a specific measurement method (for example, the use of a discounted probability-weighted expected value).

A91. The auditor may develop a point estimate or a range in a number of ways, for example, by:

- Using a model, for example, one that is commercially available for use in a particular sector or industry, or a proprietary or auditor-developed model.

- Further developing management's consideration of alternative assumptions or outcomes, for example, by introducing a different set of assumptions.

- Employing or engaging a person with specialized expertise to develop or execute the model, or to provide relevant assumptions.

- Making reference to other comparable conditions, transactions or events, or, where relevant, markets for comparable assets or liabilities.

Understanding Management's Assumptions or Method (Ref: Para. 13(d)(i))

A92. When the auditor develops a point estimate or a range and uses assumptions or a method different from those used by management, paragraph 13(d)(i) requires the auditor to obtain a sufficient understanding of the assumptions or method used by management in making the accounting estimate. This understanding provides the auditor with information that may be relevant to the auditor's development of an appropriate point estimate or range. Further, it assists the auditor to understand and evaluate any significant differences from management's point estimate. For example, a difference may arise because the auditor used different, but equally valid, assumptions as compared with those used by management.

This may reveal that the accounting estimate is highly sensitive to certain assumptions and therefore subject to high estimation uncertainty, indicating that the accounting estimate may be a significant risk. Alternatively, a difference may arise as a result of a factual error made by management. Depending on the circumstances, the auditor may find it helpful in drawing conclusions to discuss with management the basis for the assumptions used and their validity, and the difference, if any, in the approach taken to making the accounting estimate.

Narrowing a Range (Ref: Para. 13(d)(ii))

A93. When the auditor concludes that it is appropriate to use a range to evaluate the reasonableness of management's point estimate (the auditor's range), paragraph 13(d)(ii) requires that range to encompass all "reasonable outcomes" rather than all possible outcomes. The range cannot be one that comprises all possible outcomes if it is to be useful, as such a range would be too wide to be effective for purposes of the audit. The auditor's range is useful and effective when it is sufficiently narrow to enable the auditor to conclude whether the accounting estimate is misstated.

A94. Ordinarily, a range that has been narrowed to be equal to or less than performance materiality is adequate for the purposes of evaluating the reasonableness of management's point estimate. However, particularly in certain industries, it may not be possible to narrow the range to below such an amount. This does not necessarily preclude recognition of the accounting estimate. It may indicate, however, that the estimation uncertainty associated with the accounting estimate is such that it gives rise to a significant risk. Additional responses to significant risks are described in paragraphs A102-A115.

A95. Narrowing the range to a position where all outcomes within the range are considered reasonable may be achieved by:

(a) Eliminating from the range those outcomes at the extremities of the range judged by the auditor to be unlikely to occur; and

(b) Continuing to narrow the range, based on audit evidence available, until the auditor concludes that all outcomes within the range are considered reasonable. In some rare cases, the auditor may be able to narrow the range until the audit evidence indicates a point estimate.

Considering Whether Specialized Skills or Knowledge Are Required (Ref: Para. 14)

A96. In planning the audit, the auditor is required to ascertain the nature, timing and extent of resources necessary to perform the audit engagement.[20] This may include, as necessary, the involvement of those with specialized skills or knowledge. In addition, HKSA 220 requires the engagement partner to be satisfied that the engagement team, and any auditor's external experts who are not part of the engagement team, collectively have the appropriate competence and capabilities to perform the audit engagement.[21] During the course of the audit of accounting estimates the auditor may identify, in light of the experience of the auditor and the circumstances of the engagement, the need for specialized skills or knowledge to be applied in relation to one or more aspects of the accounting estimates.

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20 HKSA 300, "Planning an Audit of Financial Statements," paragraph 8(e).

21 HKSA 220, "Quality Control for an Audit of Financial Statements," paragraph 14.

A97. Matters that may affect the auditor's consideration of whether specialized skills or knowledge is required include, for example:

- The nature of the underlying asset, liability or component of equity in a particular business or industry (for example, mineral deposits, agricultural assets, complex financial instruments).
- A high degree of estimation uncertainty.
- Complex calculations or specialized models are involved, for example, when estimating fair values when there is no observable market.
- The complexity of the requirements of the applicable financial reporting framework relevant to accounting estimates, including whether there are areas known to be subject to differing interpretation or practice is inconsistent or developing.
- The procedures the auditor intends to undertake in responding to assessed risks.

A98. For the majority of accounting estimates, even when there is estimation uncertainty, it is unlikely that specialized skills or knowledge will be required. For example, it is unlikely that specialized skills or knowledge would be necessary for an auditor to evaluate an allowance for doubtful accounts.

A99. However, the auditor may not possess the specialized skills or knowledge required when the matter involved is in a field other than accounting or auditing and may need to obtain it from an auditor's expert. HKSA 620 [22] establishes requirements and provides guidance in determining the need to employ or engage an auditor's expert and the auditor's responsibilities when using the work of an auditor's expert.

A100. Further, in some cases, the auditor may conclude that it is necessary to obtain specialized skills or knowledge related to specific areas of accounting or auditing. Individuals with such skills or knowledge may be employed by the auditor's firm or engaged from an external organization outside of the auditor's firm. Where such individuals perform audit procedures on the engagement, they are part of the engagement team and accordingly, they are subject to the requirements in HKSA 220.

A101. Depending on the auditor's understanding and experience of working with the auditor's expert or those other individuals with specialized skills or knowledge, the auditor may consider it appropriate to discuss matters such as the requirements of the applicable financial reporting framework with the individuals involved to establish that their work is relevant for audit purposes.

Further Substantive Procedures to Respond to Significant Risks (Ref: Para. 15)

A102. In auditing accounting estimates that give rise to significant risks, the auditor's further substantive procedures are focused on the evaluation of:

(a) How management has assessed the effect of estimation uncertainty on the accounting estimate, and the effect such uncertainty may have on the appropriateness of the recognition of the accounting estimate in the financial statements; and

(b) The adequacy of related disclosures.

[22] HKSA 620, "Using the Work of an Auditor's Expert."

Estimation Uncertainty

Management's Consideration of Estimation Uncertainty (Ref: Para. 15(a))

A103. Management may evaluate alternative assumptions or outcomes of the accounting estimates through a number of methods, depending on the circumstances. One possible method used by management is to undertake a sensitivity analysis. This might involve determining how the monetary amount of an accounting estimate varies with different assumptions. Even for accounting estimates measured at fair value there can be variation because different market participants will use different assumptions. A sensitivity analysis could lead to the development of a number of outcome scenarios, sometimes characterized as a range of outcomes by management, such as "pessimistic" and "optimistic" scenarios.

A104. A sensitivity analysis may demonstrate that an accounting estimate is not sensitive to changes in particular assumptions. Alternatively, it may demonstrate that the accounting estimate is sensitive to one or more assumptions that then become the focus of the auditor's attention.

A105. This is not intended to suggest that one particular method of addressing estimation uncertainty (such as sensitivity analysis) is more suitable than another, or that management's consideration of alternative assumptions or outcomes needs to be conducted through a detailed process supported by extensive documentation. Rather, it is whether management has assessed how estimation uncertainty may affect the accounting estimate that is important, not the specific manner in which it is done. Accordingly, where management has not considered alternative assumptions or outcomes, it may be necessary for the auditor to discuss with management, and request support for, how it has addressed the effects of estimation uncertainty on the accounting estimate.

Considerations specific to smaller entities

A106. Smaller entities may use simple means to assess the estimation uncertainty. In addition to the auditor's review of available documentation, the auditor may obtain other audit evidence of management consideration of alternative assumptions or outcomes by inquiry of management. In addition, management may not have the expertise to consider alternative outcomes or otherwise address the estimation uncertainty of the accounting estimate. In such cases, the auditor may explain to management the process or the different methods available for doing so, and the documentation thereof. This would not, however, change the responsibilities of management for the preparation of the financial statements.

Significant Assumptions (Ref: Para. 15(b))

A107. An assumption used in making an accounting estimate may be deemed to be significant if a reasonable variation in the assumption would materially affect the measurement of the accounting estimate.

A108. Support for significant assumptions derived from management's knowledge may be obtained from management's continuing processes of strategic analysis and risk management. Even without formal established processes, such as may be the case in smaller entities, the auditor may be able to evaluate the assumptions through inquiries of and discussions with management, along with other audit procedures in order to obtain sufficient appropriate audit evidence.

A109. The auditor's considerations in evaluating assumptions made by management are described in paragraphs A77-A83.

Management Intent and Ability (Ref: Para. 15(c))

A110. The auditor's considerations in relation to assumptions made by management and management's intent and ability are described in paragraphs A13 and A80.

Development of a Range (Ref: Para. 16)

A111. In preparing the financial statements, management may be satisfied that it has adequately addressed the effects of estimation uncertainty on the accounting estimates that give rise to significant risks. In some circumstances, however, the auditor may view the efforts of management as inadequate. This may be the case, for example, where, in the auditor's judgment:

- Sufficient appropriate audit evidence could not be obtained through the auditor's evaluation of how management has addressed the effects of estimation uncertainty.
- It is necessary to explore further the degree of estimation uncertainty associated with an accounting estimate, for example, where the auditor is aware of wide variation in outcomes for similar accounting estimates in similar circumstances.
- It is unlikely that other audit evidence can be obtained, for example, through the review of events occurring up to the date of the auditor's report.
- Indicators of management bias in the making of accounting estimates may exist.

A112. The auditor's considerations in determining a range for this purpose are described in paragraphs A87-A95.

Recognition and Measurement Criteria

Recognition of the Accounting Estimates in the Financial Statements (Ref: Para. 17(a))

A113. Where management has recognized an accounting estimate in the financial statements, the focus of the auditor's evaluation is on whether the measurement of the accounting estimate is sufficiently reliable to meet the recognition criteria of the applicable financial reporting framework.

A114. With respect to accounting estimates that have not been recognized, the focus of the auditor's evaluation is on whether the recognition criteria of the applicable financial reporting framework have in fact been met. Even where an accounting estimate has not been recognized, and the auditor concludes that this treatment is appropriate, there may be a need for disclosure of the circumstances in the notes to the financial statements. Where applicable, ~~T~~the auditor may also determine that ~~there is a need to draw the reader's attention to a significant~~an accounting estimate that has been identified as having a high estimation uncertainty ~~by adding an Emphasis of Matter paragraph to the auditor's report.~~ is a key audit matter to be communicated in the auditor's report in accordance with HKSA 701,[23] or may consider it necessary to include an Emphasis of Matter paragraph in the auditor's report (see HKSA 706 (Revised).[24] ~~establishes requirements and provides guidance concerning such paragraphs.~~ If the matter is determined to be a key audit matter, HKSA 706 (Revised) prohibits the auditor from including an Emphasis of Matter paragraph in the auditor's report.[25]

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

[24] HKSA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*

[25] HKSA 706 (Revised), paragraph 8(b)

Measurement Basis for the Accounting Estimates (Ref: Para. 17(b))

A115. With respect to fair value accounting estimates, some financial reporting frameworks presume that fair value can be measured reliably as a prerequisite to either requiring or permitting fair value measurements and disclosures. In some cases, this presumption may be overcome when, for example, there is no appropriate method or basis for measurement. In such cases, the focus of the auditor's evaluation is on whether management's basis for overcoming the presumption relating to the use of fair value set forth under the applicable financial reporting framework is appropriate.

Evaluating the Reasonableness of the Accounting Estimates, and Determining Misstatements (Ref: Para. 18)

A116. Based on the audit evidence obtained, the auditor may conclude that the evidence points to an accounting estimate that differs from management's point estimate. Where the audit evidence supports a point estimate, the difference between the auditor's point estimate and management's point estimate constitutes a misstatement. Where the auditor has concluded that using the auditor's range provides sufficient appropriate audit evidence, a management point estimate that lies outside the auditor's range would not be supported by audit evidence. In such cases, the misstatement is no less than the difference between management's point estimate and the nearest point of the auditor's range.

A117. Where management has changed an accounting estimate, or the method in making it, from the prior period based on a subjective assessment that there has been a change in circumstances, the auditor may conclude based on the audit evidence that the accounting estimate is misstated as a result of an arbitrary change by management, or may regard it as an indicator of possible management bias (see paragraphs A124-A125).

A118. HKSA 450[26] provides guidance on distinguishing misstatements for purposes of the auditor's evaluation of the effect of uncorrected misstatements on the financial statements. In relation to accounting estimates, a misstatement, whether caused by fraud or error, may arise as a result of:

- Misstatements about which there is no doubt (factual misstatements).
- Differences arising from management's judgments concerning accounting estimates that the auditor considers unreasonable, or the selection or application of accounting policies that the auditor considers inappropriate (judgmental misstatements).
- The auditor's best estimate of misstatements in populations, involving the projection of misstatements identified in audit samples to the entire populations from which the samples were drawn (projected misstatements).

In some cases involving accounting estimates, a misstatement could arise as a result of a combination of these circumstances, making separate identification difficult or impossible.

A119. Evaluating the reasonableness of accounting estimates and related disclosures included in the notes to the financial statements, whether required by the applicable financial reporting framework or disclosed voluntarily, involves essentially the same types of considerations applied when auditing an accounting estimate recognized in the financial statements.

[26] HKSA 450, "Evaluation of Misstatements Identified during the Audit."

Disclosures Related to Accounting Estimates

Disclosures in Accordance with the Applicable Financial Reporting Framework (Ref: Para. 19)

A120. The presentation of financial statements in accordance with the applicable financial reporting framework includes adequate disclosure of material matters. The applicable financial reporting framework may permit, or prescribe, disclosures related to accounting estimates, and some entities may disclose voluntarily additional information in the notes to the financial statements. These disclosures may include, for example:

- The assumptions used.
- The method of estimation used, including any applicable model.
- The basis for the selection of the method of estimation.
- The effect of any changes to the method of estimation from the prior period.
- The sources and implications of estimation uncertainty.

Such disclosures are relevant to users in understanding the accounting estimates recognized or disclosed in the financial statements, and sufficient appropriate audit evidence needs to be obtained about whether the disclosures are in accordance with the requirements of the applicable financial reporting framework.

A121. In some cases, the applicable financial reporting framework may require specific disclosures regarding uncertainties. For example, some financial reporting frameworks prescribe:

- The disclosure of key assumptions and other sources of estimation uncertainty that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities. Such requirements may be described using terms such as "Key Sources of Estimation Uncertainty" or "Critical Accounting Estimates."
- The disclosure of the range of possible outcomes, and the assumptions used in determining the range.
- The disclosure of information regarding the significance of fair value accounting estimates to the entity's financial position and performance.
- Qualitative disclosures such as the exposures to risk and how they arise, the entity's objectives, policies and procedures for managing the risk and the methods used to measure the risk and any changes from the previous period of these qualitative concepts.
- Quantitative disclosures such as the extent to which the entity is exposed to risk, based on information provided internally to the entity's key management personnel, including credit risk, liquidity risk and market risk.

Disclosures of Estimation Uncertainty for Accounting Estimates that Give Rise to Significant Risks (Ref: Para. 20)

A122. In relation to accounting estimates having significant risk, even where the disclosures are in accordance with the applicable financial reporting framework, the auditor may conclude that the disclosure of estimation uncertainty is inadequate in light of the circumstances and facts involved. The auditor's evaluation of the adequacy of disclosure of estimation uncertainty increases in importance the greater the range of possible outcomes of the accounting estimate is in relation to materiality (see related discussion in paragraph A94).

A123. In some cases, the auditor may consider it appropriate to encourage management to describe, in the notes to the financial statements, the circumstances relating to the estimation uncertainty. HKSA 705 [27] provides guidance on the implications for the auditor's opinion when the auditor believes that management's disclosure of estimation uncertainty in the financial statements is inadequate or misleading.

Indicators of Possible Management Bias (Ref: Para. 21)

A124. During the audit, the auditor may become aware of judgments and decisions made by management which give rise to indicators of possible management bias. Such indicators may affect the auditor's conclusion as to whether the auditor's risk assessment and related responses remain appropriate, and the auditor may need to consider the implications for the rest of the audit. Further, they may affect the auditor's evaluation of whether the financial statements as a whole are free from material misstatement, as discussed in HKSA 700.[28]

A125. Examples of indicators of possible management bias with respect to accounting estimates include:

- Changes in an accounting estimate, or the method for making it, where management has made a subjective assessment that there has been a change in circumstances.
- Use of an entity's own assumptions for fair value accounting estimates when they are inconsistent with observable marketplace assumptions.
- Selection or construction of significant assumptions that yield a point estimate favorable for management objectives.
- Selection of a point estimate that may indicate a pattern of optimism or pessimism.

Written Representations (Ref: Para. 22)

A126. HKSA 580 [29] discusses the use of written representations. Depending on the nature, materiality and extent of estimation uncertainty, written representations about accounting estimates recognized or disclosed in the financial statements may include representations:

- About the appropriateness of the measurement processes, including related assumptions and models, used by management in determining accounting estimates in the context of the applicable financial reporting framework, and the consistency in application of the processes.
- That the assumptions appropriately reflect management's intent and ability to carry out specific courses of action on behalf of the entity, where relevant to the accounting estimates and disclosures.
- That disclosures related to accounting estimates are complete and appropriate under the applicable financial reporting framework.
- That no subsequent event requires adjustment to the accounting estimates and disclosures included in the financial statements.

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[27] HKSA 705, "Modifications to the Opinion in the Independent Auditor's Report."

[28] HKSA 700, "Forming an Opinion and Reporting on Financial Statements."

[29] HKSA 580, "Written Representations."

A127. For those accounting estimates not recognized or disclosed in the financial statements, written representations may also include representations about:

- The appropriateness of the basis used by management for determining that the recognition or disclosure criteria of the applicable financial reporting framework have not been met (see paragraph A114).
- The appropriateness of the basis used by management to overcome the presumption relating to the use of fair value set forth under the entity's applicable financial reporting framework, for those accounting estimates not measured or disclosed at fair value (see paragraph A115).

Documentation (Ref: Para. 23)

A128. Documentation of indicators of possible management bias identified during the audit assists the auditor in concluding whether the auditor's risk assessment and related responses remain appropriate, and in evaluating whether the financial statements as a whole are free from material misstatement. See paragraph A125 for examples of indicators of possible management bias.

Appendix

(Ref: Para. A1)

Fair Value Measurements and Disclosures under Different Financial Reporting Frameworks

The purpose of this appendix is only to provide a general discussion of fair value measurements and disclosures under different financial reporting frameworks, for background and context.

1. Different financial reporting frameworks require or permit a variety of fair value measurements and disclosures in financial statements. They also vary in the level of guidance that they provide on the basis for measuring assets and liabilities or the related disclosures. Some financial reporting frameworks give prescriptive guidance, others give general guidance, and some give no guidance at all. In addition, certain industry-specific measurement and disclosure practices for fair values also exist.

2. Definitions of fair value may differ among financial reporting frameworks, or for different assets, liabilities or disclosures within a particular framework. For example, Hong Kong Accounting Standard (HKAS) 39[1] defines fair value as "the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction." The concept of fair value ordinarily assumes a current transaction, rather than settlement at some past or future date. Accordingly, the process of measuring fair value would be a search for the estimated price at which that transaction would occur. Additionally, different financial reporting frameworks may use such terms as "entity-specific value," "value in use," or similar terms, but may still fall within the concept of fair value in this HKSA.

3. Financial reporting frameworks may treat changes in fair value measurements that occur over time in different ways. For example, a particular financial reporting framework may require that changes in fair value measurements of certain assets or liabilities be reflected directly in equity, while such changes might be reflected in income under another framework. In some frameworks, the determination of whether to use fair value accounting or how it is applied is influenced by management's intent to carry out certain courses of action with respect to the specific asset or liability.

4. Different financial reporting frameworks may require certain specific fair value measurements and disclosures in financial statements and prescribe or permit them in varying degrees. The financial reporting frameworks may:

   - Prescribe measurement, presentation and disclosure requirements for certain information included in the financial statements or for information disclosed in notes to financial statements or presented as supplementary information;

   - Permit certain measurements using fair values at the option of an entity or only when certain criteria have been met;

   - Prescribe a specific method for determining fair value, for example, through the use of an independent appraisal or specified ways of using discounted cash flows;

   - Permit a choice of method for determining fair value from among several alternative methods (the criteria for selection may or may not be provided by the financial reporting framework); or

[1] HKAS 39, "Financial Instruments: Recognition and Measurement."

- Provide no guidance on the fair value measurements or disclosures of fair value other than their use being evident through custom or practice, for example, an industry practice.

5. Some financial reporting frameworks presume that fair value can be measured reliably for assets or liabilities as a prerequisite to either requiring or permitting fair value measurements or disclosures. In some cases, this presumption may be overcome when an asset or liability does not have a quoted market price in an active market and for which other methods of reasonably estimating fair value are clearly inappropriate or unworkable. Some financial reporting frameworks may specify a fair value hierarchy that distinguishes inputs for use in arriving at fair values ranging from those that involve clearly "observable inputs" based on quoted prices and active markets and those "unobservable inputs" that involve an entity's own judgments about assumptions that marketplace participants would use.

6. Some financial reporting frameworks require certain specified adjustments or modifications to valuation information, or other considerations unique to a particular asset or liability. For example, accounting for investment properties may require adjustments to be made to an appraised market value, such as adjustments for estimated closing costs on sale, adjustments related to the property's condition and location, and other matters. Similarly, if the market for a particular asset is not an active market, published price quotations may have to be adjusted or modified to arrive at a more suitable measure of fair value. For example, quoted market prices may not be indicative of fair value if there is infrequent activity in the market, the market is not well established, or small volumes of units are traded relative to the aggregate number of trading units in existence. Accordingly, such market prices may have to be adjusted or modified. Alternative sources of market information may be needed to make such adjustments or modifications. Further, in some cases, collateral assigned (for example, when collateral is assigned for certain types of investment in debt) may need to be considered in determining the fair value or possible impairment of an asset or liability.

7. In most financial reporting frameworks, underlying the concept of fair value measurements is a presumption that the entity is a going concern without any intention or need to liquidate, curtail materially the scale of its operations, or undertake a transaction on adverse terms. Therefore, in this case, fair value would not be the amount that an entity would receive or pay in a forced transaction, involuntary liquidation, or distress sale. On the other hand, general economic conditions or economic conditions specific to certain industries may cause illiquidity in the marketplace and require fair values to be predicated upon depressed prices, potentially significantly depressed prices. An entity, however, may need to take its current economic or operating situation into account in determining the fair values of its assets and liabilities if prescribed or permitted to do so by its financial reporting framework and such framework may or may not specify how that is done. For example, management's plan to dispose of an asset on an accelerated basis to meet specific business objectives may be relevant to the determination of the fair value of that asset.

Prevalence of Fair Value Measurements

8. Measurements and disclosures based on fair value are becoming increasingly prevalent in financial reporting frameworks. Fair values may occur in, and affect the determination of, financial statements in a number of ways, including the measurement at fair value of the following:

   - Specific assets or liabilities, such as marketable securities or liabilities to settle an obligation under a financial instrument, routinely or periodically "marked-to-market."

- Specific components of equity, for example when accounting for the recognition, measurement and presentation of certain financial instruments with equity features, such as a bond convertible by the holder into common shares of the issuer.

- Specific assets or liabilities acquired in a business combination. For example, the initial determination of goodwill arising on the purchase of an entity in a business combination usually is based on the fair value measurement of the identifiable assets and liabilities acquired and the fair value of the consideration given.

- Specific assets or liabilities adjusted to fair value on a one-time basis. Some financial reporting frameworks may require the use of a fair value measurement to quantify an adjustment to an asset or a group of assets as part of an asset impairment determination, for example, a test of impairment of goodwill acquired in a business combination based on the fair value of a defined operating entity or reporting unit, the value of which is then allocated among the entity's or unit's group of assets and liabilities in order to derive an implied goodwill for comparison to the recorded goodwill.

- Aggregations of assets and liabilities. In some circumstances, the measurement of a class or group of assets or liabilities calls for an aggregation of fair values of some of the individual assets or liabilities in such class or group. For example, under an entity's applicable financial reporting framework, the measurement of a diversified loan portfolio might be determined based on the fair value of some categories of loans comprising the portfolio.

- Information disclosed in notes to financial statements or presented as supplementary information, but not recognized in the financial statements.

HKSA 560

Issued July 2009; revised July 2010, August 2015*

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

Hong Kong Standard on Auditing 560

Subsequent Events

* Conforming amendments have been made to this HKSA as a result of the new and revised HKSAs issued in Update 172, and will become effective for audits of financial statements for periods ending on or after 15 December 2016. The conforming amendments are underlined for easy reference.

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HONG KONG STANDARD ON AUDITING 560

SUBSEQUENT EVENTS

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

CONTENTS

Hong Kong Standard on Auditing (HKSA) 560, "Subsequent Events" should be read in conjunction with HKSA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing."

Introduction

Scope of this HKSA

1. This Hong Kong Standard on Auditing (HKSA) deals with the auditor's responsibilities relating to subsequent events in an audit of financial statements. It does not deal with matters relating to the auditor's responsibilities for other information obtained after the date of the auditor's report, which are addressed in HKSA 720 (Revised).[1] However, such other information may bring to light a subsequent event that is within the scope of this HKSA. (Ref: Para. A1)

Subsequent Events

2. Financial statements may be affected by certain events that occur after the date of the financial statements. Many financial reporting frameworks specifically refer to such events.[2] Such financial reporting frameworks ordinarily identify two types of events:

   (a) Those that provide evidence of conditions that existed at the date of the financial statements; and

   (b) Those that provide evidence of conditions that arose after the date of the financial statements.

   HKSA 700 explains that the date of the auditor's report informs the reader that the auditor has considered the effect of events and transactions of which the auditor becomes aware and that occurred up to that date.[3]

Effective Date

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

Objectives

4. The objectives of the auditor are:

   (a) To obtain sufficient appropriate audit evidence about whether events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements are appropriately reflected in those financial statements in accordance with the applicable financial reporting framework; and

   (b) To respond appropriately to facts that become known to the auditor after the date of the auditor's report, that, had they been known to the auditor at that date, may have caused the auditor to amend the auditor's report.

Definitions

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

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[1] HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*

[2] For example, Hong Kong Accounting Standard (HKAS) 10, *Events After the Reporting Period* deals with the treatment in financial statements of events, both favorable and unfavorable, that occur between the date of the financial statements (referred to as the "end of the reporting period" in the HKAS) and the date when the financial statements are authorized for issue.

[3] HKSA 700, *Forming an Opinion and Reporting on Financial Statements*, paragraph A38.

(a) Date of the financial statements – The date of the end of the latest period covered by the financial statements.

(b) Date of approval of the financial statements – The date on which all the statements that comprise the financial statements, including the related notes, have been prepared and those with the recognized authority have asserted that they have taken responsibility for those financial statements. (Ref: Para. A2)

(c) Date of the auditor's report – The date the auditor dates the report on the financial statements in accordance with HKSA 700. (Ref: Para. A3)

(d) Date the financial statements are issued – The date that the auditor's report and audited financial statements are made available to third parties. (Ref: Para. A4-A5)

(e) Subsequent events – Events occurring between the date of the financial statements and the date of the auditor's report, and facts that become known to the auditor after the date of the auditor's report.

Requirements

Events Occurring between the Date of the Financial Statements and the Date of the Auditor's Report

6. The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified. The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions. (Ref: Para. A6)

7. The auditor shall perform the procedures required by paragraph 6 so that they cover the period from the date of the financial statements to the date of the auditor's report, or as near as practicable thereto. The auditor shall take into account the auditor's risk assessment in determining the nature and extent of such audit procedures, which shall include the following: (Ref: Para. A7-A8)

   (a) Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.

   (b) Inquiring of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements. (Ref: Para. A9)

   (c) Reading minutes, if any, of the meetings of the entity's owners, management and those charged with governance that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available. (Ref: Para. A10)

   (d) Reading the entity's latest subsequent interim financial statements, if any.

8. If, as a result of the procedures performed as required by paragraphs 6 and 7, the auditor identifies events that require adjustment of, or disclosure in, the financial statements, the auditor shall determine whether each such event is appropriately reflected in those financial statements in accordance with the applicable financial reporting framework.

Written Representations

9. The auditor shall request management and, where appropriate, those charged with governance, to provide a written representation in accordance with HKSA 580 [4] that all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed.

Facts Which Become Known to the Auditor after the Date of the Auditor's Report but before the Date the Financial Statements are Issued

10. The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, if, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall: (Ref: Para. A11)

    (a) Discuss the matter with management and, where appropriate, those charged with governance;

    (b) Determine whether the financial statements need amendment and, if so,

    (c) Inquire how management intends to address the matter in the financial statements.

11. If management amends the financial statements, the auditor shall:

    (a) Carry out the audit procedures necessary in the circumstances on the amendment.

    (b) Unless the circumstances in paragraph 12 apply:

        (i) Extend the audit procedures referred to in paragraphs 6 and 7 to the date of the new auditor's report; and

        (ii) Provide a new auditor's report on the amended financial statements. The new auditor's report shall not be dated earlier than the date of approval of the amended financial statements.

12. Where law, regulation or the financial reporting framework does not prohibit management from restricting the amendment of the financial statements to the effects of the subsequent event or events causing that amendment and those responsible for approving the financial statements are not prohibited from restricting their approval to that amendment, the auditor is permitted to restrict the audit procedures on subsequent events required in paragraph 11(b)(i) to that amendment. In such cases, the auditor shall either:

    (a) Amend the auditor's report to include an additional date restricted to that amendment that thereby indicates that the auditor's procedures on subsequent events are restricted solely to the amendment of the financial statements described in the relevant note to the financial statements; or (Ref: Para. A12)

    (b) Provide a new or amended auditor's report that includes a statement in an Emphasis of Matter paragraph [5] or Other Matter paragraph that conveys that the auditor's procedures on subsequent events are restricted solely to the amendment of the financial statements as described in the relevant note to the financial statements.

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4 HKSA 580, "Written Representations."

5 See HKSA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report."

13. In some jurisdictions, management may not be required by law, regulation or the financial reporting framework to issue amended financial statements and, accordingly, the auditor need not provide an amended or new auditor's report. However, if management does not amend the financial statements in circumstances where the auditor believes they need to be amended, then: (Ref: Para. A13-A14)

    (a) If the auditor's report has not yet been provided to the entity, the auditor shall modify the opinion as required by HKSA 705 [6] and then provide the auditor's report; or

    (b) If the auditor's report has already been provided to the entity, the auditor shall notify management and, unless all of those charged with governance are involved in managing the entity, those charged with governance, not to issue the financial statements to third parties before the necessary amendments have been made. If the financial statements are nevertheless subsequently issued without the necessary amendments, the auditor shall take appropriate action to seek to prevent reliance on the auditor's report. (Ref. Para: A15-A16)

Facts Which Become Known to the Auditor after the Financial Statements Have Been Issued

14. After the financial statements have been issued, the auditor has no obligation to perform any audit procedures regarding such financial statements. However, if, after the financial statements have been issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall:

    (a) Discuss the matter with management and, where appropriate, those charged with governance;

    (b) Determine whether the financial statements need amendment; and, if so,

    (c) Inquire how management intends to address the matter in the financial statements.

15. If management amends the financial statements, the auditor shall: (Ref: Para. A17)

    (a) Carry out the audit procedures necessary in the circumstances on the amendment.

    (b) Review the steps taken by management to ensure that anyone in receipt of the previously issued financial statements together with the auditor's report thereon is informed of the situation.

    (c) Unless the circumstances in paragraph 12 apply:

        (i) Extend the audit procedures referred to in paragraphs 6 and 7 to the date of the new auditor's report, and date the new auditor's report no earlier than the date of approval of the amended financial statements; and

        (ii) Provide a new auditor's report on the amended financial statements.

    (d) When the circumstances in paragraph 12 apply, amend the auditor's report, or provide a new auditor's report as required by paragraph 12.

[6] HKSA 705, "Modifications to the Opinion in the Independent Auditor's Report."

16. The auditor shall include in the new or amended auditor's report an Emphasis of Matter paragraph or Other Matter paragraph referring to a note to the financial statements that more extensively discusses the reason for the amendment of the previously issued financial statements and to the earlier report provided by the auditor.

17. If management does not take the necessary steps to ensure that anyone in receipt of the previously issued financial statements is informed of the situation and does not amend the financial statements in circumstances where the auditor believes they need to be amended, the auditor shall notify management and, unless all of those charged with governance are involved in managing the entity,[7] those charged with governance, that the auditor will seek to prevent future reliance on the auditor's report. If, despite such notification, management or those charged with governance do not take these necessary steps, the auditor shall take appropriate action to seek to prevent reliance on the auditor's report. (Ref: Para. A18)

Conformity and Compliance with International Standards on Auditing

18. As of July 2009 (date of issue), this HKSA conforms with International Standard on Auditing (ISA) 560, "Subsequent Events". Compliance with the requirements of this HKSA ensures compliance with ISA 560.

***

Application and Other Explanatory Material

Scope of this HKSA (Ref: Para. 1)

A1. When the audited financial statements are included in other documents subsequent to the issuance of the financial statements (other than annual reports that would be within the scope of HKSA 720 (Revised)), the auditor may have additional responsibilities relating to subsequent events that the auditor may need to consider, such as legal or regulatory requirements involving the offering of securities to the public in jurisdictions in which the securities are being offered. For example, the auditor may be required to perform additional audit procedures to the date of the final offering document. These procedures may include those referred to in paragraphs 6 and 7 performed up to a date at or near the effective date of the final offering document, and reading the offering document to assess whether the other information in the offering document is consistent with the financial information with which the auditor is associated.[8]

Definitions

Date of Approval of the Financial Statements (Ref: Para. 5(b))

A2. In some jurisdictions, law or regulation identifies the individuals or bodies (for example, management or those charged with governance) that are responsible for concluding that all the statements that comprise the financial statements, including the related notes, have been prepared, and specifies the necessary approval process. In other jurisdictions, the approval process is not prescribed in law or regulation and the entity follows its own procedures in preparing and finalizing its financial statements in view of its management and governance structures. In some jurisdictions, final approval of the financial statements by shareholders is required. In these jurisdictions, final approval by shareholders is not necessary for the auditor to conclude that sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements has been obtained. The date of approval of the financial statements for purposes of the HKSAs is the earlier date on which those with the recognized

[7] HKSA 260, "Communication with Those Charged with Governance," paragraph 13.

[8] See HKSA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing," paragraph 2.

authority determine that all the statements that comprise the financial statements, including the related notes, have been prepared and that those with the recognized authority have asserted that they have taken responsibility for those financial statements.

Date of the Auditor's Report (Ref: Para. 5(c))

A3. The auditor's report cannot be dated earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the opinion on the financial statements, including evidence that all the statements that comprise the financial statements, including the related notes, have been prepared and that those with the recognized authority have asserted that they have taken responsibility for those financial statements.[9] Consequently, the date of the auditor's report cannot be earlier than the date of approval of the financial statements as defined in paragraph 5(b). A time period may elapse due to administrative issues between the date of the auditor's report as defined in paragraph 5(c) and the date the auditor's report is provided to the entity.

Date the Financial Statements Are Issued (Ref: Para. 5(d))

A4. The date the financial statements are issued generally depends on the regulatory environment of the entity. In some circumstances, the date the financial statements are issued may be the date that they are filed with a regulatory authority. Since audited financial statements cannot be issued without an auditor's report, the date that the audited financial statements are issued must not only be at or later than the date of the auditor's report, but must also be at or later than the date the auditor's report is provided to the entity.

Considerations Specific to Public Sector Entities

A5. In the case of the public sector, the date the financial statements are issued may be the date the audited financial statements and the auditor's report thereon are presented to the legislature or otherwise made public.

Events Occurring between the Date of the Financial Statements and the Date of the Auditor's Report (Ref: Para. 6-9)

A6. Depending on the auditor's risk assessment, the audit procedures required by paragraph 6 may include procedures, necessary to obtain sufficient appropriate audit evidence, involving the review or testing of accounting records or transactions occurring between the date of the financial statements and the date of the auditor's report. The audit procedures required by paragraphs 6 and 7 are in addition to procedures that the auditor may perform for other purposes that, nevertheless, may provide evidence about subsequent events (for example, to obtain audit evidence for account balances as at the date of the financial statements, such as cutoff procedures or procedures in relation to subsequent receipts of accounts receivable).

A7. Paragraph 7 stipulates certain audit procedures in this context that the auditor is required to perform pursuant to paragraph 6. The subsequent events procedures that the auditor performs may, however, depend on the information that is available and, in particular, the extent to which the accounting records have been prepared since the date of the financial statements. Where the accounting records are not up-to-date, and accordingly no interim financial statements (whether for internal or external purposes) have been prepared, or minutes of meetings of management or those charged with governance have not been prepared, relevant audit procedures may take the form of inspection of available books and records, including bank statements. Paragraph A8 gives examples of some of the additional matters that the auditor may consider in the course of these inquiries.

[9] HKSA 700, paragraph 41. In some cases, law or regulation also identifies the point in the financial statement reporting process at which the audit is expected to be complete.

A8. In addition to the audit procedures required by paragraph 7, the auditor may consider it necessary and appropriate to:

- Read the entity's latest available budgets, cash flow forecasts and other related management reports for periods after the date of the financial statements;
- Inquire, or extend previous oral or written inquiries, of the entity's legal counsel concerning litigation and claims; or
- Consider whether written representations covering particular subsequent events may be necessary to support other audit evidence and thereby obtain sufficient appropriate audit evidence.

Inquiry (Ref: Para. 7(b))

A9. In inquiring of management and, where appropriate, those charged with governance, as to whether any subsequent events have occurred that might affect the financial statements, the auditor may inquire as to the current status of items that were accounted for on the basis of preliminary or inconclusive data and may make specific inquiries about the following matters:

- Whether new commitments, borrowings or guarantees have been entered into.
- Whether sales or acquisitions of assets have occurred or are planned.
- Whether there have been increases in capital or issuance of debt instruments, such as the issue of new shares or debentures, or an agreement to merge or liquidate has been made or is planned.
- Whether any assets have been appropriated by government or destroyed, for example, by fire or flood.
- Whether there have been any developments regarding contingencies.
- Whether any unusual accounting adjustments have been made or are contemplated.
- Whether any events have occurred or are likely to occur that will bring into question the appropriateness of accounting policies used in the financial statements, as would be the case, for example, if such events call into question the validity of the going concern assumption.
- Whether any events have occurred that are relevant to the measurement of estimates or provisions made in the financial statements.
- Whether any events have occurred that are relevant to the recoverability of assets.

Reading Minutes (Ref: Para. 7(c))

Considerations Specific to Public Sector Entities

A10. In the public sector, the auditor may read the official records of relevant proceedings of the legislature and inquire about matters addressed in proceedings for which official records are not yet available.

Facts Which Become Known to the Auditor after the Date of the Auditor's Report but before the Date the Financial Statements are Issued

Implications of Other Information Obtained after the Date of the Auditor's Report (Ref: Para. 10)

A10a. While the auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report but before the date the financial statements are issued, HKSA 720 (Revised) contains requirements and guidance with respect to other information obtained after the date of the auditor's report, which might include other information obtained after the date of the auditor's report, but before the date the financial statements are issued. [*]

Management Responsibility towards Auditor (Ref: Para. 10)

A11. As explained in HKSA 210, the terms of the audit engagement include the agreement of management to inform the auditor of facts that may affect the financial statements, of which management may become aware during the period from the date of the auditor's report to the date the financial statements are issued.[10]

Dual Dating (Ref: Para. 12(a))

A12. When, in the circumstances described in paragraph 12(a), the auditor amends the auditor's report to include an additional date restricted to that amendment, the date of the auditor's report on the financial statements prior to their subsequent amendment by management remains unchanged because this date informs the reader as to when the audit work on those financial statements was completed. However, an additional date is included in the auditor's report to inform users that the auditor's procedures subsequent to that date were restricted to the subsequent amendment of the financial statements. The following is an illustration of such an additional date:

> (Date of auditor's report), except as to Note Y, which is as of (date of completion of audit procedures restricted to amendment described in Note Y).

No Amendment of Financial Statements by Management (Ref: Para. 13)

A13. In some jurisdictions, management may not be required by law, regulation or the financial reporting framework to issue amended financial statements. This is often the case when issuance of the financial statements for the following period is imminent, provided appropriate disclosures are made in such statements.

Considerations Specific to Public Sector Entities

A14. In the public sector, the actions taken in accordance with paragraph 13 when management does not amend the financial statements may also include reporting separately to the legislature, or other relevant body in the reporting hierarchy, on the implications of the subsequent event for the financial statements and the auditor's report.

Auditor Action to Seek to Prevent Reliance on Auditor's Report (Ref: Para. 13(b))

A15. The auditor may need to fulfill additional legal obligations even when the auditor has notified management not to issue the financial statements and management has agreed to this request.

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[*] When the conforming amendment becomes effective, this paragraph will become paragraph A11 and all subsequent paragraphs will be renumbered accordingly.

[10] HKSA 210, "Agreeing the Terms of Audit Engagements," paragraph A23.

A16. Where management has issued the financial statements despite the auditor's notification not to issue the financial statements to third parties, the auditor's course of action to prevent reliance on the auditor's report on the financial statements depends upon the auditor's legal rights and obligations. Consequently, the auditor may consider it appropriate to seek legal advice.

Facts Which Become Known to the Auditor after the Financial Statements Have Been Issued

Implications of Other Information Received after the Financial Statements Have Been Issued (Ref: Para. 14)

A16a. The auditor's obligations regarding other information received after the date of the auditor's report are addressed in HKSA 720 (Revised). While the auditor has no obligation to perform any audit procedures regarding the financial statements after the financial statements have been issued, HKSA 720 (Revised) contains requirements and guidance with respect to other information obtained after the date of the auditor's report.*

No Amendment of Financial Statements by Management (Ref: Para. 15)

Considerations Specific to Public Sector Entities

A17. In some jurisdictions, entities in the public sector may be prohibited from issuing amended financial statements by law or regulation. In such circumstances, the appropriate course of action for the auditor may be to report to the appropriate statutory body.

Auditor Action to Seek to Prevent Reliance on Auditor's Report (Ref: Para. 17)

A18. Where the auditor believes that management, or those charged with governance, have failed to take the necessary steps to prevent reliance on the auditor's report on financial statements previously issued by the entity despite the auditor's prior notification that the auditor will take action to seek to prevent such reliance, the auditor's course of action depends upon the auditor's legal rights and obligations. Consequently, the auditor may consider it appropriate to seek legal advice.

* When the conforming amendment becomes effective, this paragraph will become paragraph A18 and all subsequent paragraphs will be renumbered accordingly.

HKSA 570 (Revised)

Issued August 2015

Effective for audits of financial statements

for periods ending on or after 15 December 2016

Hong Kong Standard on Auditing 570 (Revised)

Going Concern

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

HONG KONG STANDARD ON AUDITING 570 (REVISED)
GOING CONCERN

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

CONTENTS

Hong Kong Standard on Auditing (HKSA) 570 (Revised), *Going Concern*, should be read in conjunction with HKSA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing*.

Introduction

Scope of this HKSA

1. This Hong Kong Standard on Auditing (HKSA) deals with the auditor's responsibilities in the audit of financial statements relating to going concern and the implications for the auditor's report. (Ref: Para. A1)

Going Concern Basis of Accounting

2. Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future. General purpose financial statements are prepared using the going concern basis of accounting, unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so. Special purpose financial statements may or may not be prepared in accordance with a financial reporting framework for which the going concern basis of accounting is relevant (e.g., the going concern basis of accounting is not relevant for some financial statements prepared on a tax basis in particular jurisdictions). When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business. (Ref: Para. A2)

Responsibility for Assessment of the Entity's Ability to Continue as a Going Concern

3. Some financial reporting frameworks contain an explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern, and standards regarding matters to be considered and disclosures to be made in connection with going concern. For example, Hong Kong Accounting Standard (HKAS) 1 requires management to make an assessment of an entity's ability to continue as a going concern.[1] The detailed requirements regarding management's responsibility to assess the entity's ability to continue as a going concern and related financial statement disclosures may also be set out in law or regulation.

4. In other financial reporting frameworks, there may be no explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern. Nevertheless, where the going concern basis of accounting is a fundamental principle in the preparation of financial statements as discussed in paragraph 2, the preparation of the financial statements requires management to assess the entity's ability to continue as a going concern even if the financial reporting framework does not include an explicit requirement to do so.

5. Management's assessment of the entity's ability to continue as a going concern involves making a judgment, at a particular point in time, about inherently uncertain future outcomes of events or conditions. The following factors are relevant to that judgment:

    - The degree of uncertainty associated with the outcome of an event or condition increases significantly the further into the future an event or condition or the outcome occurs. For that reason, most financial reporting frameworks that require an explicit management assessment specify the period for which management is required to take into account all available information.

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1 HKAS 1, *Presentation of Financial Statements*, paragraphs 25–26

- The size and complexity of the entity, the nature and condition of its business and the degree to which it is affected by external factors affect the judgment regarding the outcome of events or conditions.
- Any judgment about the future is based on information available at the time at which the judgment is made. Subsequent events may result in outcomes that are inconsistent with judgments that were reasonable at the time they were made.

Responsibilities of the Auditor

6. The auditor's responsibilities are to obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements, and to conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern. These responsibilities exist even if the financial reporting framework used in the preparation of the financial statements does not include an explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern.

7. However, as described in HKSA 200,[2] the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for future events or conditions that may cause an entity to cease to continue as a going concern. The auditor cannot predict such future events or conditions. Accordingly, the absence of any reference to a material uncertainty about the entity's ability to continue as a going concern in an auditor's report cannot be viewed as a guarantee as to the entity's ability to continue as a going concern.

Effective Date

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

Objectives

9. The objectives of the auditor are:

   (a) To obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements;

   (b) To conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern; and

   (c) To report in accordance with this HKSA.

Requirements

Risk Assessment Procedures and Related Activities

10. When performing risk assessment procedures as required by HKSA 315 (Revised),[3] the auditor shall consider whether events or conditions exist that may cast significant doubt on the entity's

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2 HKSA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing*, paragraphs A51–A52

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

ability to continue as a going concern. In so doing, the auditor shall determine whether management has already performed a preliminary assessment of the entity's ability to continue as a going concern, and: (Ref: Para. A3–A6)

(a) If such an assessment has been performed, the auditor shall discuss the assessment with management and determine whether management has identified events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern and, if so, management's plans to address them; or

(b) If such an assessment has not yet been performed, the auditor shall discuss with management the basis for the intended use of the going concern basis of accounting, and inquire of management whether events or conditions exist that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern.

11. The auditor shall remain alert throughout the audit for audit evidence of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. (Ref: Para. A7)

Evaluating Management's Assessment

12. The auditor shall evaluate management's assessment of the entity's ability to continue as a going concern. (Ref: Para. A8–A10, A12–A13)

13. In evaluating management's assessment of the entity's ability to continue as a going concern, the auditor shall cover the same period as that used by management to make its assessment as required by the applicable financial reporting framework, or by law or regulation if it specifies a longer period. If management's assessment of the entity's ability to continue as a going concern covers less than twelve months from the date of the financial statements as defined in HKSA 560,[4] the auditor shall request management to extend its assessment period to at least twelve months from that date. (Ref: Para. A11–A13)

14. In evaluating management's assessment, the auditor shall consider whether management's assessment includes all relevant information of which the auditor is aware as a result of the audit.

Period beyond Management's Assessment

15. The auditor shall inquire of management as to its knowledge of events or conditions beyond the period of management's assessment that may cast significant doubt on the entity's ability to continue as a going concern. (Ref: Para. A14–A15)

Additional Audit Procedures When Events or Conditions Are Identified

16. If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern (hereinafter referred to as "material uncertainty") through performing additional audit procedures, including consideration of mitigating factors. These procedures shall include: (Ref: Para. A16)

(a) Where management has not yet performed an assessment of the entity's ability to continue as a going concern, requesting management to make its assessment.

4 HKSA 560, *Subsequent Events*, paragraph 5(a)

(b) Evaluating management's plans for future actions in relation to its going concern assessment, whether the outcome of these plans is likely to improve the situation and whether management's plans are feasible in the circumstances. (Ref: Para. A17)

(c) Where the entity has prepared a cash flow forecast, and analysis of the forecast is a significant factor in considering the future outcome of events or conditions in the evaluation of management's plans for future actions: (Ref: Para. A18–A19)

(i) Evaluating the reliability of the underlying data generated to prepare the forecast; and

(ii) Determining whether there is adequate support for the assumptions underlying the forecast.

(d) Considering whether any additional facts or information have become available since the date on which management made its assessment.

(e) Requesting written representations from management and, where appropriate, those charged with governance, regarding their plans for future actions and the feasibility of these plans. (Ref: Para. A20)

Auditor Conclusions

17. The auditor shall evaluate whether sufficient appropriate audit evidence has been obtained regarding, and shall conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements.

18. Based on the audit evidence obtained, the auditor shall conclude whether, in the auditor's judgment, a material uncertainty exists related to events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern. A material uncertainty exists when the magnitude of its potential impact and likelihood of occurrence is such that, in the auditor's judgment, appropriate disclosure of the nature and implications of the uncertainty is necessary for: (Ref: Para. A21–A22)

(a) In the case of a fair presentation financial reporting framework, the fair presentation of the financial statements, or

(b) In the case of a compliance framework, the financial statements not to be misleading.

Adequacy of Disclosures When Events or Conditions Have Been Identified and a Material Uncertainty Exists

19. If the auditor concludes that management's use of the going concern basis of accounting is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements: (Ref: Para. A22–A23)

(a) Adequately disclose the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and

(b) Disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.

Adequacy of Disclosures When Events or Conditions Have Been Identified but No Material Uncertainty Exists

20. If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern but, based on the audit evidence obtained the auditor concludes that no material uncertainty exists, the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosures about these events or conditions. (Ref: Para. A24–A25)

Implications for the Auditor's Report

Use of Going Concern Basis of Accounting Is Inappropriate

21. If the financial statements have been prepared using the going concern basis of accounting but, in the auditor's judgment, management's use of the going concern basis of accounting in the preparation of the financial statements is inappropriate, the auditor shall express an adverse opinion. (Ref: Para. A26–A27)

Use of Going Concern Basis of Accounting Is Appropriate but a Material Uncertainty Exists

Adequate Disclosure of a Material Uncertainty Is Made in the Financial Statements

22. If adequate disclosure about the material uncertainty is made in the financial statements, the auditor shall express an unmodified opinion and the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" to: (Ref: Para. A28–A31, A34)

    (a) Draw attention to the note in the financial statements that discloses the matters set out in paragraph 19; and

    (b) State that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.

Adequate Disclosure of a Material Uncertainty Is Not Made in the Financial Statements

23. If adequate disclosure about the material uncertainty is not made in the financial statements, the auditor shall: (Ref: Para. A32–A34)

    (a) Express a qualified opinion or adverse opinion, as appropriate, in accordance with HKSA 705 (Revised)[5]; and

    (b) In the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

Management Unwilling to Make or Extend Its Assessment

24. If management is unwilling to make or extend its assessment when requested to do so by the auditor, the auditor shall consider the implications for the auditor's report. (Ref: Para. A35)

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

Communication with Those Charged with Governance

25. Unless all those charged with governance are involved in managing the entity,[6] the auditor shall communicate with those charged with governance events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern. Such communication with those charged with governance shall include the following:

    (a) Whether the events or conditions constitute a material uncertainty;

    (b) Whether management's use of the going concern basis of accounting is appropriate in the preparation of the financial statements;

    (c) The adequacy of related disclosures in the financial statements; and

    (d) Where applicable, the implications for the auditor's report.

Significant Delay in the Approval of Financial Statements

26. If there is significant delay in the approval of the financial statements by management or those charged with governance after the date of the financial statements, the auditor shall inquire as to the reasons for the delay. If the auditor believes that the delay could be related to events or conditions relating to the going concern assessment, the auditor shall perform those additional audit procedures necessary, as described in paragraph 16, as well as consider the effect on the auditor's conclusion regarding the existence of a material uncertainty, as described in paragraph 18.

Conformity and Compliance with International Standards on Auditing

27. As of August 2015 (date of issue), this HKSA conforms with International Standard on Auditing (ISA) 570 (Revised) *Going Concern*. Compliance with the requirements of this HKSA ensures compliance with ISA 570 (Revised).

28. Additional local explanation and guidance is provided in Appendix.

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[6] HKSA 260 (Revised), *Communication with Those Charged with Governance*, paragraph 13

Application and Other Explanatory Material

Scope of this HKSA (Ref: Para 1)

A1. HKSA 701[7] deals with the auditor's responsibility to communicate key audit matters in the auditor's report. That HKSA acknowledges that, when HKSA 701 applies, matters relating to going concern may be determined to be key audit matters, and explains that a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern is, by its nature, a key audit matter.[8]

Going Concern Basis of Accounting (Ref: Para. 2)

Considerations Specific to Public Sector Entities

A2. Management's use of the going concern basis of accounting is also relevant to public sector entities.[9] Going concern risks may arise, but are not limited to, situations where public sector entities operate on a for-profit basis, where government support may be reduced or withdrawn, or in the case of privatization. Events or conditions that may cast significant doubt on an entity's ability to continue as a going concern in the public sector may include situations where the public sector entity lacks funding for its continued existence or when policy decisions are made that affect the services provided by the public sector entity.

Risk Assessment Procedures and Related Activities

Events or Conditions That May Cast Significant Doubt on the Entity's Ability to Continue as a Going Concern (Ref: Para. 10)

A3. The following are examples of events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern. This listing is not all-inclusive nor does the existence of one or more of the items always signify that a material uncertainty exists.

Financial

- Net liability or net current liability position.
- Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets.
- Indications of withdrawal of financial support by creditors.
- Negative operating cash flows indicated by historical or prospective financial statements.
- Adverse key financial ratios.
- Substantial operating losses or significant deterioration in the value of assets used to generate cash flows.
- Arrears or discontinuance of dividends.
- Inability to pay creditors on due dates.
- Inability to comply with the terms of loan agreements.

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

8 See paragraphs 15 and A41 of HKSA 701.

9 Not used.

- Change from credit to cash-on-delivery transactions with suppliers.
- Inability to obtain financing for essential new product development or other essential investments.

Operating

- Management intentions to liquidate the entity or to cease operations.
- Loss of key management without replacement.
- Loss of a major market, key customer(s), franchise, license, or principal supplier(s).
- Labor difficulties.
- Shortages of important supplies.
- Emergence of a highly successful competitor.

Other

- Non-compliance with capital or other statutory or regulatory requirements, such as solvency or liquidity requirements for financial institutions.
- Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy.
- Changes in law or regulation or government policy expected to adversely affect the entity.
- Uninsured or underinsured catastrophes when they occur.

The significance of such events or conditions often can be mitigated by other factors. For example, the effect of an entity being unable to make its normal debt repayments may be counter-balanced by management's plans to maintain adequate cash flows by alternative means, such as by disposing of assets, rescheduling loan repayments, or obtaining additional capital. Similarly, the loss of a principal supplier may be mitigated by the availability of a suitable alternative source of supply.

A4. The risk assessment procedures required by paragraph 10 help the auditor to determine whether management's use of the going concern basis of accounting is likely to be an important issue and its impact on planning the audit. These procedures also allow for more timely discussions with management, including a discussion of management's plans and resolution of any identified going concern issues.

Considerations Specific to Smaller Entities (Ref: Para. 10)

A5. The size of an entity may affect its ability to withstand adverse conditions. Small entities may be able to respond quickly to exploit opportunities, but may lack reserves to sustain operations.

A6. Conditions of particular relevance to small entities include the risk that banks and other lenders may cease to support the entity, as well as the possible loss of a principal supplier, major customer, key employee, or the right to operate under a license, franchise or other legal agreement.

Remaining Alert throughout the Audit for Audit Evidence about Events or Conditions (Ref: Para. 11)

A7. HKSA 315 (Revised) requires the auditor to revise the auditor's risk assessment and modify the further planned audit procedures accordingly when additional audit evidence is obtained during the course of the audit that affects the auditor's assessment of risk.[10] If events or conditions that may cast significant doubt on the entity's ability to continue as a going concern are identified after the auditor's risk assessments are made, in addition to performing the procedures in paragraph 16, the auditor's assessment of the risks of material misstatement may need to be revised. The existence of such events or conditions may also affect the nature, timing and extent of the auditor's further procedures in response to the assessed risks. HKSA 330[11] establishes requirements and provides guidance on this issue.

Evaluating Management's Assessment

Management's Assessment and Supporting Analysis and the Auditor's Evaluation (Ref: Para. 12)

A8. Management's assessment of the entity's ability to continue as a going concern is a key part of the auditor's consideration of management's use of the going concern basis of accounting.

A9. It is not the auditor's responsibility to rectify the lack of analysis by management. In some circumstances, however, the lack of detailed analysis by management to support its assessment may not prevent the auditor from concluding whether management's use of the going concern basis of accounting is appropriate in the circumstances. For example, when there is a history of profitable operations and a ready access to financial resources, management may make its assessment without detailed analysis. In this case, the auditor's evaluation of the appropriateness of management's assessment may be made without performing detailed evaluation procedures if the auditor's other audit procedures are sufficient to enable the auditor to conclude whether management's use of the going concern basis of accounting in the preparation of the financial statements is appropriate in the circumstances.

A10. In other circumstances, evaluating management's assessment of the entity's ability to continue as a going concern, as required by paragraph 12, may include an evaluation of the process management followed to make its assessment, the assumptions on which the assessment is based and management's plans for future action and whether management's plans are feasible in the circumstances.

The Period of Management's Assessment (Ref: Para. 13)

A11. Most financial reporting frameworks requiring an explicit management assessment specify the period for which management is required to take into account all available information.[12]

Considerations Specific to Smaller Entities (Ref: Para. 12–13)

A12. In many cases, the management of smaller entities may not have prepared a detailed assessment of the entity's ability to continue as a going concern, but instead may rely on in-depth knowledge of the business and anticipated future prospects. Nevertheless, in accordance with the requirements of this HKSA, the auditor needs to evaluate management's assessment of the entity's ability to continue as a going concern. For smaller entities, it may be appropriate to discuss the medium and long-term financing of the entity with management, provided that management's contentions can be corroborated by sufficient documentary evidence and are not inconsistent with the auditor's understanding of the entity. Therefore, the requirement in paragraph 13 for the auditor to request

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[10] HKSA 315 (Revised), paragraph 31

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

[12] For example, HKAS 1 defines this as a period that should be at least, but is not limited to, twelve months from the end of the reporting period.

management to extend its assessment may, for example, be satisfied by discussion, inquiry and inspection of supporting documentation, for example, orders received for future supply, evaluated as to their feasibility or otherwise substantiated.

A13. Continued support by owner-managers is often important to smaller entities' ability to continue as a going concern. Where a small entity is largely financed by a loan from the owner-manager, it may be important that these funds are not withdrawn. For example, the continuance of a small entity in financial difficulty may be dependent on the owner-manager subordinating a loan to the entity in favor of banks or other creditors, or the owner-manager supporting a loan for the entity by providing a guarantee with his or her personal assets as collateral. In such circumstances, the auditor may obtain appropriate documentary evidence of the subordination of the owner-manager's loan or of the guarantee. Where an entity is dependent on additional support from the owner-manager, the auditor may evaluate the owner-manager's ability to meet the obligation under the support arrangement. In addition, the auditor may request written confirmation of the terms and conditions attaching to such support and the owner-manager's intention or understanding.

Period beyond Management's Assessment (Ref: Para. 15)

A14. As required by paragraph 11, the auditor remains alert to the possibility that there may be known events, scheduled or otherwise, or conditions that will occur beyond the period of assessment used by management that may bring into question the appropriateness of management's use of the going concern basis of accounting in preparing the financial statements. Since the degree of uncertainty associated with the outcome of an event or condition increases as the event or condition is further into the future, in considering events or conditions further in the future, the indications of going concern issues need to be significant before the auditor needs to consider taking further action. If such events or conditions are identified, the auditor may need to request management to evaluate the potential significance of the event or condition on its assessment of the entity's ability to continue as a going concern. In these circumstances, the procedures in paragraph 16 apply.

A15. Other than inquiry of management, the auditor does not have a responsibility to perform any other audit procedures to identify events or conditions that may cast significant doubt on the entity's ability to continue as a going concern beyond the period assessed by management, which, as discussed in paragraph 13, would be at least twelve months from the date of the financial statements.

Additional Audit Procedures When Events or Conditions Are Identified (Ref: Para.16)

A16. Audit procedures that are relevant to the requirement in paragraph 16 may include the following:

- Analyzing and discussing cash flow, profit and other relevant forecasts with management.
- Analyzing and discussing the entity's latest available interim financial statements.
- Reading the terms of debentures and loan agreements and determining whether any have been breached.
- Reading minutes of the meetings of shareholders, those charged with governance and relevant committees for reference to financing difficulties.
- Inquiring of the entity's legal counsel regarding the existence of litigation and claims and the reasonableness of management's assessments of their outcome and the estimate of their financial implications.

- Confirming the existence, legality and enforceability of arrangements to provide or maintain financial support with related and third parties and assessing the financial ability of such parties to provide additional funds.
- Evaluating the entity's plans to deal with unfilled customer orders.
- Performing audit procedures regarding subsequent events to identify those that either mitigate or otherwise affect the entity's ability to continue as a going concern.
- Confirming the existence, terms and adequacy of borrowing facilities.
- Obtaining and reviewing reports of regulatory actions.
- Determining the adequacy of support for any planned disposals of assets.

Evaluating Management's Plans for Future Actions (Ref: Para. 16(b))

A17. Evaluating management's plans for future actions may include inquiries of management as to its plans for future action, including, for example, its plans to liquidate assets, borrow money or restructure debt, reduce or delay expenditures, or increase capital.

The Period of Management's Assessment (Ref: Para. 16(c))

A18. In addition to the procedures required in paragraph 16(c), the auditor may compare:

- The prospective financial information for recent prior periods with historical results; and
- The prospective financial information for the current period with results achieved to date.

A19. Where management's assumptions include continued support by third parties, whether through the subordination of loans, commitments to maintain or provide additional funding, or guarantees, and such support is important to an entity's ability to continue as a going concern, the auditor may need to consider requesting written confirmation (including of terms and conditions) from those third parties and to obtain evidence of their ability to provide such support.

Written Representations (Ref: Para. 16(e))

A20. The auditor may consider it appropriate to obtain specific written representations beyond those required in paragraph 16 in support of audit evidence obtained regarding management's plans for future actions in relation to its going concern assessment and the feasibility of those plans.

Auditor Conclusions

Material Uncertainty Related to Events or Conditions that May Cast Significant Doubt on the Entity's Ability to Continue as a Going Concern (Ref: Para. 18–19)

A21. The phrase "material uncertainty" is used in HKAS 1 in discussing the uncertainties related to events or conditions which may cast significant doubt on the entity's ability to continue as a going concern that should be disclosed in the financial statements. In some other financial reporting frameworks the phrase "significant uncertainty" is used in similar circumstances.

Adequacy of Disclosure when Events or Conditions Have Been Identified and a Material Uncertainty Exists

A22. Paragraph 18 explains that a material uncertainty exists when the magnitude of the potential impact of the events or conditions and the likelihood of occurrence is such that appropriate disclosure is necessary to achieve fair presentation (for fair presentation frameworks) or for the financial statements not to be misleading (for compliance frameworks). The auditor is required by paragraph 18 to conclude whether such a material uncertainty exists regardless of whether or how the applicable financial reporting framework defines a material uncertainty.

A23. Paragraph 19 requires the auditor to determine whether the financial statement disclosures address the matters set forth in that paragraph. This determination is in addition to the auditor determining whether disclosures about a material uncertainty, required by the applicable financial reporting framework, are adequate. Disclosures required by some financial reporting frameworks that are in addition to matters set forth in paragraph 19 may include disclosures about:

- Management's evaluation of the significance of the events or conditions relating to the entity's ability to meet its obligations; or
- Significant judgments made by management as part of its assessment of the entity's ability to continue as a going concern.

Some financial reporting frameworks may provide additional guidance regarding management's consideration of disclosures about the magnitude of the potential impact of the principal events or conditions, and the likelihood and timing of their occurrence.

Adequacy of Disclosures When Events or Conditions Have Been Identified but No Material Uncertainty Exists (Ref: Para. 20)

A24. Even when no material uncertainty exists, paragraph 20 requires the auditor to evaluate whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosure about events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. Some financial reporting frameworks may address disclosures about:

- Principal events or conditions;
- Management's evaluation of the significance of those events or conditions in relation to the entity's ability to meet its obligations;
- Management's plans that mitigate the effect of these events or conditions; or
- Significant judgments made by management as part of its assessment of the entity's ability to continue as a going concern.

A25. When the financial statements are prepared in accordance with a fair presentation framework, the auditor's evaluation as to whether the financial statements achieve fair presentation includes the consideration of the overall presentation, structure and content of the financial statements, and whether the financial statements, including the related notes, represent the underlying transactions and events in a manner that achieves fair presentation.[13] Depending on the facts and circumstances, the auditor may determine that additional disclosures are necessary to achieve fair presentation. This may be the case, for example, when events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern but, based on

[13] HKSA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements,* paragraph 14

the audit evidence obtained, the auditor concludes that no material uncertainty exists, and no disclosures are explicitly required by the applicable financial reporting framework regarding these circumstances.

Implications for the Auditor's Report

Use of Going Concern Basis of Accounting is Inappropriate (Ref: Para. 21)

A26. If the financial statements have been prepared using the going concern basis of accounting but, in the auditor's judgment, management's use of the going concern basis of accounting in the financial statements is inappropriate, the requirement in paragraph 21 for the auditor to express an adverse opinion applies regardless of whether or not the financial statements include disclosure of the inappropriateness of management's use of the going concern basis of accounting.

A27. When the use of the going concern basis of accounting is not appropriate in the circumstances, management may be required, or may elect, to prepare the financial statements on another basis (e.g., liquidation basis). The auditor may be able to perform an audit of those financial statements provided that the auditor determines that the other basis of accounting is acceptable in the circumstances. The auditor may be able to express an unmodified opinion on those financial statements, provided there is adequate disclosure therein about the basis of accounting on which the financial statements are prepared, but may consider it appropriate or necessary to include an Emphasis of Matter paragraph in accordance with HKSA 706 (Revised)[14] in the auditor's report to draw the user's attention to that alternative basis of accounting and the reasons for its use.

Use of the Going Concern Basis of Accounting Is Appropriate but a Material Uncertainty Exists (Ref: Para. 22–23)

A28. The identification of a material uncertainty is a matter that is important to users' understanding of the financial statements. The use of a separate section with a heading that includes reference to the fact that a material uncertainty related to going concern exists alerts users to this circumstance.

A29. The Appendix to this HKSA provides illustrations of the statements that are required to be included in the auditor's report on the financial statements when Hong Kong Financial Reporting Standards (HKFRSs) is the applicable financial reporting framework. If an applicable financial reporting framework other than HKFRSs is used, the illustrative statements presented in the Appendix to this HKSA may need to be adapted to reflect the application of the other financial reporting framework in the circumstances.

A30. Paragraph 22 establishes the minimum information required to be presented in the auditor's report in each of the circumstances described. The auditor may provide additional information to supplement the required statements, for example to explain:

- That the existence of a material uncertainty is fundamental to users' understanding of the financial statements;[15] or
- How the matter was addressed in the audit. (Ref: Para. A1)

[14] HKSA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*

[15] HKSA 706 (Revised), paragraph A2

Adequate Disclosure of a Material Uncertainty Is Made in the Financial Statements (Ref: Para. 22)

A31. Illustration 1 of the Appendix to this HKSA is an example of an auditor's report when the auditor has obtained sufficient appropriate audit evidence regarding the appropriateness of management's use of the going concern basis of accounting but a material uncertainty exists and disclosure is adequate in the financial statements. The Appendix of HKSA 700 (Revised) also includes illustrative wording to be included in the auditor's report for all entities in relation to going concern to describe the respective responsibilities of those responsible for the financial statements and the auditor in relation to going concern.

Adequate Disclosure of a Material Uncertainty Is Not Made in the Financial Statements (Ref: Para. 23)

A32. Illustrations 2 and 3 of the Appendix to this HKSA are examples of auditor's reports containing qualified and adverse opinions, respectively, when the auditor has obtained sufficient appropriate audit evidence regarding the appropriateness of the management's use of the going concern basis of accounting but adequate disclosure of a material uncertainty is not made in the financial statements.

A33. In situations involving multiple uncertainties that are significant to the financial statements as a whole, the auditor may consider it appropriate in extremely rare cases to express a disclaimer of opinion instead of including the statements required by paragraph 22. HKSA 705 (Revised) provides guidance on this issue.[16]

Communication with Regulators (Ref: Para. 22–23)

A34. When the auditor of a regulated entity considers that it may be necessary to include a reference to going concern matters in the auditor's report, the auditor may have a duty to communicate with the applicable regulatory, enforcement or supervisory authorities.

Management Unwilling to Make or Extend Its Assessment (Ref: Para. 24)

A35. In certain circumstances, the auditor may believe it necessary to request management to make or extend its assessment. If management is unwilling to do so, a qualified opinion or a disclaimer of opinion in the auditor's report may be appropriate, because it may not be possible for the auditor to obtain sufficient appropriate audit evidence regarding management's use of the going concern basis of accounting in the preparation of the financial statements, such as audit evidence regarding the existence of plans management has put in place or the existence of other mitigating factors.

[16] HKSA 705 (Revised), paragraph 10

Appendix

(Ref: Para. A29, A31–A32)

Illustrations of Auditor's Reports Relating to Going Concern

- Illustration 1: An auditor's report containing an unmodified opinion when the auditor has concluded that a material uncertainty exists and disclosure in the financial statements is adequate.
- Illustration 2: An auditor's report containing a qualified opinion when the auditor has concluded that a material uncertainty exists and that the financial statements are materially misstated due to inadequate disclosure.
- Illustration 3: An auditor's report containing an adverse opinion when the auditor has concluded that a material uncertainty exists and the financial statements omit the required disclosures relating to a material uncertainty.

Illustration 1 – Unmodified Opinion When a Material Uncertainty Exists and Disclosure in the Financial Statements Is Adequate

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of a listed entity using Hong Kong Financial Reporting Standards (HKFRSs). The audit is not a group audit (i.e., HKSA 600[1] does not apply).
- The financial statements are prepared by the directors of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of the directors' responsibility for the financial statements in HKSA 210.[2]
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. The disclosure of the material uncertainty in the financial statements is adequate.
- Key audit matters have been communicated in accordance with HKSA 701.
- The auditor has obtained all of the other information prior to the date of the auditor's report and has not identified a material misstatement of the other information.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company

(incorporated in Hong Kong with limited liability)[2a]

Report on the Audit of the Financial Statements[3]

Opinion

We have audited the financial statements of ABC Company ("the Company") set out on pages …… to ……, which comprise the statement of financial position as at 31 December 20X1, and [the statement of profit or loss and][3a] the statement of profit or loss and other comprehensive income, statement of changes

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1 HKSA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors*

2 HKSA 210, *Agreeing the Terms of Audit Engagements*

2a In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

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

3a HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.

in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

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") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") 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"), and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Material Uncertainty Related to Going Concern

We draw attention to Note 6 in the financial statements, which indicates that the Company incurred a net loss of ZZZ during the year ended 31 December 20X1 and, as of that date, the Company's current liabilities exceeded its total assets by YYY. As stated in Note 6, these events or conditions, along with other matters as set forth in Note 6, indicate that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

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. In addition to the matter described in the *Material Uncertainty Related to Going Concern* section, we have determined the matters described below to be the key audit matters to be communicated in our report.

[*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 Statements[4]

[Reporting in accordance with HKSA 700 (Revised) – see Illustration 1 in HKSA 700 (Revised).[5]]

4 Throughout these illustrative auditor's reports, the terms directors and those charged with governance may need to be replaced by another term that is appropriate in the context of the legal framework in the particular jurisdiction.

5 Paragraphs 34 and 39 of HKSA 700 (Revised) require wording to be included in the auditor's report for all entities in relation to going concern to describe the respective responsibilities of those responsible for the financial statements and the auditor in relation to going concern.

Auditor's Responsibilities for the Audit of the Financial Statements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 1 in HKSA 700 (Revised)*.[5]]

Report on Other Legal and Regulatory Requirements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 1 in HKSA 700 (Revised)*.]

The engagement partner on the audit resulting in this independent auditor's report is [*name*].

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[*Auditor Address*]

[*Date*]

Illustration 2 – Qualified Opinion When a Material Uncertainty Exists and the Financial Statements Are Materially Misstated Due to Inadequate Disclosure

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of a listed entity using Hong Kong Financial Reporting Standards (HKFRSs). The audit is not a group audit (i.e., HKSA 600 does not apply).
- The financial statements are prepared by the directors of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of the directors' responsibility for the financial statements in HKSA 210.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. Note yy to the financial statements discusses the magnitude of financing arrangements, the expiration and the total financing arrangements; however the financial statements do not include discussion on the impact or the availability of refinancing or characterize this situation as a material uncertainty.
- The financial statements are materially misstated due to the inadequate disclosure of the material uncertainty. A qualified opinion is being expressed because the auditor concluded that the effects on the financial statements of this inadequate disclosure are material but not pervasive to the financial statements.
- Key audit matters have been communicated in accordance with HKSA 701.
- The auditor has obtained all of the other information prior to the date of the auditor's report and the matter giving rise to the qualified opinion on the financial statements also affects the other information.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company

(incorporated in Hong Kong with limited liability)[5a]

Report on the Audit of the Financial Statements[6]

Qualified Opinion

We have audited the financial statements of ABC Company ("the Company") set out on pages …… to ……, which comprise the statement of financial position as at 31 December 20X1, and [the statement of

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[5a] In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

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

profit or loss and][6a] the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, except for the incomplete disclosure of the information referred to in the *Basis for Qualified Opinion* section of our report, 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") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Qualified Opinion

As discussed in Note yy, the Company's financing arrangements expire and amounts outstanding are payable on 19 March 20X2. The Company has been unable to conclude re-negotiations or obtain replacement financing. This situation indicates that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. The financial statements do not adequately disclose this matter.

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") 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"), and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

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 6 in Appendix 2 of HKSA 720 (Revised). The last paragraph of the other information section in Illustration 6 would be customized to describe the specific matter giving rise to the qualified opinion that also affects the other information.*]

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. In addition to the matter described in the *Basis for Qualified Opinion* section, we have determined the matters described below to be the key audit matters to be communicated in our report.

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

[6a] HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.

Responsibilities of Directors and Those Charged with Governance for the Financial Statements[7]

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 1 in HKSA 700 (Revised)*. [8]]

Auditor's Responsibilities for the Audit of the Financial Statements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 1 in HKSA 700 (Revised)*.[8]]

Report on Other Legal and Regulatory Requirements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 1 in HKSA 700 (Revised)*.]

The engagement partner on the audit resulting in this independent auditor's report is [*name*].

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[*Auditor Address*]

[*Date*]

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

8 Paragraphs 34 and 39 of HKSA 700 (Revised) require wording to be included in the auditor’s report for all entities in relation to going concern to describe the respective responsibilities of those responsible for the financial statements and the auditor in relation to going concern.

Illustration 3 – Adverse Opinion When a Material Uncertainty Exists and Is Not Disclosed in the Financial Statements

For purposes of the illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of an entity other than a listed entity using Hong Kong Financial Reporting Standards (HKFRSs). The audit is not a group audit (i.e., HKSA 600 does not apply).
- The financial statements are prepared by the directors of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of the directors' responsibility for the financial statements in HKSA 210.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, and the Company is considering bankruptcy. The financial statements omit the required disclosures relating to the material uncertainty. An adverse opinion is being expressed because the effects on the financial statements of such omission are material and pervasive.
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with HKSA 701.
- The auditor has obtained all of the other information prior to the date of the auditor's report and the matter giving rise to the qualified/adverse opinion on the consolidated financial statements also affects the other information.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company

(incorporated in Hong Kong with limited liability)[8a]

Report on the Audit of the Financial Statements[9]

Adverse Opinion

We have audited the financial statements of ABC Company ("the Company") set out on pages …… to ……, which comprise the statement of financial position as at 31 December 20X1, and [the statement of profit or loss and][9a] the statement of profit or loss and other comprehensive income, statement of changes

[8a] In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

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

[9a] HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.

in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, because of the omission of the information mentioned in the *Basis for Adverse Opinion* section of our report, the financial statements do not 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"). In all other respects, in our opinion the financial statements have been properly prepared in compliance with the Hong Kong Companies Ordinance.[9b]

Basis for Adverse Opinion

The Company's financing arrangements expired and the amount outstanding was payable on 31 December 20X1. The Company has been unable to conclude re-negotiations or obtain replacement financing and is considering filing for bankruptcy. This situation indicates that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. The financial statements do not adequately disclose this fact.

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") 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"), and we have fulfilled our ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse opinion.

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 7 in Appendix 2 of HKSA 720 (Revised). The last paragraph of the other information section in Illustration 7 would be customized to describe the specific matter giving rise to the qualified opinion that also affects the other information.*]

Responsibilities of Directors and Those Charged with Governance for the Financial Statements[10]

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 3 in HKSA 700 (Revised)*. [11]]

Auditor's Responsibilities for the Audit of the Financial Statements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 3 in HKSA 700 (Revised).*[11]]

9b Assume the financial statements have been properly prepared in accordance with the Hong Kong Companies Ordinance in all other respects.

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

11 Paragraphs 34 and 39 of HKSA 700 (Revised) require wording to be included in the auditor’s report for all entities in relation to going concern to describe the respective responsibilities of those responsible for the financial statements and the auditor in relation to going concern.

Report on Other Legal and Regulatory Requirements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 3 in HKSA 700 (Revised).*]

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[*Auditor Address*]

[*Date*]

HKSA 580
Issued July 2009; revised July 2010, June 2014*, August 2015**

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

Hong Kong Standard on Auditing 580

Written Representations

** Conforming amendments have been made to this HKSA as a result of the new and revised HKSAs issued in Update 172, and will become effective for audits of financial statements for periods ending on or after 15 December 2016. The conforming amendments are underlined for easy reference.

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

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

HONG KONG STANDARD ON AUDITING 580

WRITTEN REPRESENTATIONS

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

CONTENTS

Hong Kong Standard on Auditing (HKSA) 580, "Written Representations" should be read in conjunction with HKSA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing."

Introduction

Scope of this HKSA

1. This Hong Kong Standard on Auditing (HKSA) deals with the auditor's responsibility to obtain written representations from management and, where appropriate, those charged with governance in an audit of financial statements.

2. Appendix 1 lists other HKSAs containing subject-matter specific requirements for written representations. The specific requirements for written representations of other HKSAs do not limit the application of this HKSA.

Written Representations as Audit Evidence

3. Audit evidence is the information used by the auditor in arriving at the conclusions on which the auditor's opinion is based.[1] Written representations are necessary information that the auditor requires in connection with the audit of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence. (Ref: Para. A1)

4. Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Furthermore, the fact that management has provided reliable written representations does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfillment of management's responsibilities, or about specific assertions.

Effective Date

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

Objectives

6. The objectives of the auditor are:

    (a) To obtain written representations from management and, where appropriate, those charged with governance that they believe that they have fulfilled their responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor;

    (b) To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations if determined necessary by the auditor or required by other HKSAs; and

    (c) To respond appropriately to written representations provided by management and, where appropriate, those charged with governance, or if management or, where appropriate, those charged with governance do not provide the written representations requested by the auditor.

[1] HKSA 500, "Audit Evidence," paragraph 5(c).

Definitions

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

   Written representation – A written statement by management provided to the auditor to confirm certain matters or to support other audit evidence. Written representations in this context do not include financial statements, the assertions therein, or supporting books and records.

8. For purposes of this HKSA, references to "management" should be read as "management and, where appropriate, those charged with governance." Furthermore, in the case of a fair presentation framework, management is responsible for the preparation and *fair* presentation of the financial statements in accordance with the applicable financial reporting framework; or the preparation of financial statements *that give a true and fair view* in accordance with the applicable financial reporting framework.

Requirements

Management from whom Written Representations Requested

9. The auditor shall request written representations from management with appropriate responsibilities for the financial statements and knowledge of the matters concerned. (Ref: Para. A2-A6)

Written Representations about Management's Responsibilities

Preparation of the Financial Statements

10. The auditor shall request management [1a] to provide a written representation that it has fulfilled its responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including, where relevant, their fair presentation, as set out in the terms of the audit engagement.[2] (Ref: Para. A7-A9, A14, A22)

Information Provided and Completeness of Transactions

11. The auditor shall request management to provide a written representation that:

    (a) It has provided the auditor with all relevant information and access as agreed in the terms of the audit engagement;[3] and

    (b) All transactions have been recorded and are reflected in the financial statements. (Ref: Para. A7-A9, A14, A22)

Description of Management's Responsibilities in the Written Representations

12. Management's responsibilities shall be described in the written representations required by paragraphs 10 and 11 in the manner in which these responsibilities are described in the terms of the audit engagement.

[1a] Under the Companies Ordinance, the directors are responsible for the preparation of financial statements showing a true and fair view.

[2] HKSA 210, "Agreeing the Terms of Audit Engagements," paragraph 6(b)(i).

[3] HKSA 210, paragraph 6(b)(iii).

Other Written Representations

13. Other HKSAs require the auditor to request written representations. If, in addition to such required representations, the auditor determines that it is necessary to obtain one or more written representations to support other audit evidence relevant to the financial statements or one or more specific assertions in the financial statements, the auditor shall request such other written representations. (Ref: Para. A10-A13, A14, A22)

Date of and Period(s) Covered by Written Representations

14. The date of the written representations shall be as near as practicable to, but not after, the date of the auditor's report on the financial statements. The written representations shall be for all financial statements and period(s) referred to in the auditor's report. (Ref: Para. A15-A18)

Form of Written Representations

15. The written representations shall be in the form of a representation letter addressed to the auditor. If law or regulation requires management to make written public statements about its responsibilities, and the auditor determines that such statements provide some or all of the representations required by paragraphs 10 or 11, the relevant matters covered by such statements need not be included in the representation letter. (Ref: Para. A19-A21)

Doubt as to the Reliability of Written Representations and Requested Written Representations Not Provided

Doubt as to the Reliability of Written Representations

16. If the auditor has concerns about the competence, integrity, ethical values or diligence of management, or about its commitment to or enforcement of these, the auditor shall determine the effect that such concerns may have on the reliability of representations (oral or written) and audit evidence in general. (Ref: Para. A24-A25)

17. In particular, if written representations are inconsistent with other audit evidence, the auditor shall perform audit procedures to attempt to resolve the matter. If the matter remains unresolved, the auditor shall reconsider the assessment of the competence, integrity, ethical values or diligence of management, or of its commitment to or enforcement of these, and shall determine the effect that this may have on the reliability of representations (oral or written) and audit evidence in general. (Ref: Para. A23)

18. If the auditor concludes that the written representations are not reliable, the auditor shall take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with HKSA 705,[4] having regard to the requirement in paragraph 20 of this HKSA.

Requested Written Representations Not Provided

19. If management does not provide one or more of the requested written representations, the auditor shall:

    (a) Discuss the matter with management;

    (b) Reevaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and

[4] HKSA 705, "Modifications to the Opinion in the Independent Auditor's Report."

(c) Take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with HKSA 705, 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 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 July 2009 (date of issue), 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 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:

- An actuary responsible for actuarially determined accounting measurements.
- Staff engineers who may have responsibility for and specialized knowledge about environmental liability measurements.
- Internal counsel who may provide information essential to provisions for legal claims.

A5. In some cases, management may include in the written representations qualifying language to the effect that representations are made to the best of its knowledge and belief. It is reasonable for the auditor to accept such wording if the auditor is satisfied that the representations are being made by those with appropriate responsibilities and knowledge of the matters included in the representations.

A6. To reinforce the need for management to make informed representations, the auditor may request that management include in the written representations confirmation that it has made such inquiries as it considered appropriate to place it in the position to be able to make the requested written representations. It is not expected that such inquiries would usually require a formal internal process beyond those already established by the entity.

Written Representations about Management's Responsibilities (Ref: Para. 10-11)

A7. Audit evidence obtained during the audit that management has fulfilled the responsibilities referred to in paragraphs 10 and 11 is not sufficient without obtaining confirmation from management that it believes that it has fulfilled those responsibilities. This is because the auditor is not able to judge solely on other audit evidence whether management has prepared and presented the financial statements and provided information to the auditor on the basis of the agreed acknowledgement and understanding of its responsibilities. For example, the auditor could not conclude that management has provided the auditor with all relevant information agreed in the terms of the audit engagement without asking it whether, and receiving confirmation that, such information has been provided.

A8. The written representations required by paragraphs 10 and 11 draw on the agreed acknowledgement and understanding of management of its responsibilities in the terms of the audit engagement by requesting confirmation that it has fulfilled them. The auditor may also ask management to reconfirm its acknowledgement and understanding of those responsibilities in written representations. This is common in certain jurisdictions, but in any event may be particularly appropriate when:

- Those who signed the terms of the audit engagement on behalf of the entity no longer have the relevant responsibilities;
- The terms of the audit engagement were prepared in a previous year;
- There is any indication that management misunderstands those responsibilities; or
- Changes in circumstances make it appropriate to do so.

Consistent with the requirement of HKSA 210,[5] such reconfirmation of management's acknowledgement and understanding of its responsibilities is not made subject to the best of management's knowledge and belief (as discussed in paragraph A5 of this HKSA).

[5] HKSA 210, paragraph 6(b).

Considerations Specific to Public Sector Entities

A9. The mandates for audits of the financial statements of public sector entities may be broader than those of other entities. As a result, the premise, relating to management's responsibilities, on which an audit of the financial statements of a public sector entity is conducted may give rise to additional written representations. These may include written representations confirming that transactions and events have been carried out in accordance with law, regulation or other authority.

Other Written Representations (Ref: Para. 13)

Additional Written Representations about the Financial Statements

A10. In addition to the written representation required by paragraph 10, the auditor may consider it necessary to request other written representations about the financial statements. Such written representations may supplement, but do not form part of, the written representation required by paragraph 10. They may include representations about the following:

- Whether the selection and application of accounting policies are appropriate; and
- Whether matters such as the following, where relevant under the applicable financial reporting framework, have been recognized, measured, presented or disclosed in accordance with that framework:
    - Plans or intentions that may affect the carrying value or classification of assets and liabilities;
    - Liabilities, both actual and contingent;
    - Title to, or control over, assets, the liens or encumbrances on assets, and assets pledged as collateral; and
    - Aspects of laws, regulations and contractual agreements that may affect the financial statements, including non-compliance.

Additional Written Representations about Information Provided to the Auditor

A11. In addition to the written representation required by paragraph 11, the auditor may consider it necessary to request management to provide a written representation that it has communicated to the auditor all deficiencies in internal control of which management is aware.

Written Representations about Specific Assertions

A12. When obtaining evidence about, or evaluating, judgments and intentions, the auditor may consider one or more of the following:

- The entity's past history in carrying out its stated intentions.
- The entity's reasons for choosing a particular course of action.
- The entity's ability to pursue a specific course of action.
- The existence or lack of any other information that might have been obtained during the course of the audit that may be inconsistent with management's judgment or intent.

A13. In addition, the auditor may consider it necessary to request management to provide written representations about specific assertions in the financial statements; in particular, to support an understanding that the auditor has obtained from other audit evidence of management's judgment or intent in relation to, or the completeness of, a specific assertion. For example, if the intent of management is important to the valuation basis for investments, it may not be possible to obtain sufficient appropriate audit evidence without a written representation from management about its intentions. Although such written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own for that assertion.

Communicating a Threshold Amount (Ref: Para. 10-11, 13)

A14. HKSA 450 requires the auditor to accumulate misstatements identified during the audit, other than those that are clearly trivial.[6] The auditor may determine a threshold above which misstatements cannot be regarded as clearly trivial. In the same way, the auditor may consider communicating to management a threshold for purposes of the requested written representations.

Date of and Period(s) Covered by Written Representations (Ref: Para. 14)

A15. Because written representations are necessary audit evidence, the auditor's opinion cannot be expressed, and the auditor's report cannot be dated, before the date of the written representations. Furthermore, because the auditor is concerned with events occurring up to the date of the auditor's report that may require adjustment to or disclosure in the financial statements, the written representations are dated as near as practicable to, but not after, the date of the auditor's report on the financial statements.

A16. In some circumstances, it may be appropriate for the auditor to obtain a written representation about a specific assertion in the financial statements during the course of the audit. Where this is the case, it may be necessary to request an updated written representation.

A17. The written representations are for all periods referred to in the auditor's report because management needs to reaffirm that the written representations it previously made with respect to the prior periods remain appropriate. The auditor and management may agree to a form of written representation that updates written representations relating to the prior periods by addressing whether there are any changes to such written representations and, if so, what they are.

A18. Situations may arise where current management were not present during all periods referred to in the auditor's report. Such persons may assert that they are not in a position to provide some or all of the written representations because they were not in place during the period. This fact, however, does not diminish such persons' responsibilities for the financial statements as a whole. Accordingly, the requirement for the auditor to request from them written representations that cover the whole of the relevant period(s) still applies.

Form of Written Representations (Ref: Para. 15)

A19. Written representations are required to be included in a representation letter addressed to the auditor. In some jurisdictions, however, management may be required by law or regulation to make a written public statement about its responsibilities. Although such statement is a representation to the users of the financial statements, or to relevant authorities, the auditor may determine that it is an appropriate form of written representation in respect of some or all of the representations required by paragraph 10 or 11. Consequently, the relevant matters covered by such statement need not be included in the representation letter. Factors that may affect the auditor's determination include:

[6] HKSA 450, "Evaluation of Misstatements Identified during the Audit," paragraph 5.

- Whether the statement includes confirmation of the fulfillment of the responsibilities referred to in paragraphs 10 and 11.
- Whether the statement has been given or approved by those from whom the auditor requests the relevant written representations.
- Whether a copy of the statement is provided to the auditor as near as practicable to, but not after, the date of the auditor's report on the financial statements (see paragraph 14).

A20. A formal statement of compliance with law or regulation, or of approval of the financial statements, would not contain sufficient information for the auditor to be satisfied that all necessary representations have been consciously made. The expression of management's responsibilities in law or regulation is also not a substitute for the requested written representations.

A21. Appendix 2 provides an illustrative example of a representation letter.

Communication with Those Charged with Governance (Ref: Para. 10-11, 13)

A22. HKSA 260 requires the auditor to communicate with those charged with governance the written representations which the auditor has requested from management.[7]

Doubt as to the Reliability of Written Representations and Requested Written Representations Not Provided

Doubt as to the Reliability of Written Representations (Ref: Para. 16-17)

A23. In the case of identified inconsistencies between one or more written representations and audit evidence obtained from another source, the auditor may consider whether the risk assessment remains appropriate and, if not, revise the risk assessment and determine the nature, timing and extent of further audit procedures to respond to the assessed risks.

A24. Concerns about the competence, integrity, ethical values or diligence of management, or about its commitment to or enforcement of these, may cause the auditor to conclude that the risk of management misrepresentation in the financial statements is such that an audit cannot be conducted. In such a case, the auditor may consider withdrawing from the engagement, where withdrawal is possible under applicable law or regulation, unless those charged with governance put in place appropriate corrective measures. Such measures, however, may not be sufficient to enable the auditor to issue an unmodified audit opinion.

A25. HKSA 230 requires the auditor to document significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.[8] The auditor may have identified significant issues relating to the competence, integrity, ethical values or diligence of management, or about its commitment to or enforcement of these, but concluded that the written representations are nevertheless reliable. In such a case, this significant matter is documented in accordance with HKSA 230.

Written Representations about Management's Responsibilities (Ref: Para. 20)

A26. As explained in paragraph A7, the auditor is not able to judge solely on other audit evidence whether management has fulfilled the responsibilities referred to in paragraphs 10 and 11. Therefore, if, as described in paragraph 20(a), the auditor concludes that the written representations about these matters are unreliable, or if management does not provide those written representations, the auditor is unable to obtain sufficient appropriate audit evidence.

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7 HKSA 260, "Communication with Those Charged with Governance," paragraph 16(c)(ii).

8 HKSA 230, "Audit Documentation," paragraphs 8(c) and 10.

The possible effects on the financial statements of such inability are not confined to specific elements, accounts or items of the financial statements and are hence pervasive. HKSA 705 requires the auditor to disclaim an opinion on the financial statements in such circumstances.[9]

A27. A written representation that has been modified from that requested by the auditor does not necessarily mean that management did not provide the written representation. However, the underlying reason for such modification may affect the opinion in the auditor's report. For example:

- The written representation about management's fulfillment of its responsibility for the preparation of the financial statements may state that management believes that, except for material non-compliance with a particular requirement of the applicable financial reporting framework, the financial statements are prepared in accordance with that framework. The requirement in paragraph 20 does not apply because the auditor concluded that management has provided reliable written representations. However, the auditor is required to consider the effect of the non-compliance on the opinion in the auditor's report in accordance with HKSA 705.

- The written representation about the responsibility of management to provide the auditor with all relevant information agreed in the terms of the audit engagement may state that management believes that, except for information destroyed in a fire, it has provided the auditor with such information. The requirement in paragraph 20 does not apply because the auditor concluded that management has provided reliable written representations. However, the auditor is required to consider the effects of the pervasiveness of the information destroyed in the fire on the financial statements and the effect thereof on the opinion in the auditor's report in accordance with HKSA 705.

[9] HKSA 705, paragraph 9.

Appendix 1

(Ref: Para. 2)

List of HKSAs Containing Requirements for Written Representations

This appendix identifies paragraphs in other HKSAs ~~in effect for audits of financial statements for periods beginning on or after 15 December 2009~~ that require 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, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures* – paragraph 22

HKSA 550, *Related Parties* – paragraph 26

HKSA 560, *Subsequent Events* – paragraph 9

HKSA 570, *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)

Appendix 2

(Ref: Para. A21)

Illustrative Representation Letter

The following illustrative letter includes written representations that are required by this and other HKSAs in effect for audits of financial statements for periods beginning on or after 15 December 2009. It is assumed in this illustration that the applicable financial reporting framework is Hong Kong Financial Reporting Standards; the requirement of HKSA 570 [1] to obtain a written representation is not relevant; and that there are no exceptions to the requested written representations. If there were exceptions, the representations would need to be modified to reflect the exceptions.

(Entity Letterhead)

(To Auditor) (Date)

This representation letter is provided in connection with your audit of the financial statements of ABC Company for the year ended 31 December 20XX [2] for the purpose of expressing an opinion as to whether the financial statements are presented fairly, in all material respects, (or *give a true and fair view*) in accordance with Hong Kong Financial Reporting Standards.

We confirm that (*, to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves*):[2a]

Financial Statements

- We have fulfilled our responsibilities, as set out in the terms of the audit engagement dated [insert date], for the preparation of the financial statements in accordance with Hong Kong Financial Reporting Standards; in particular the financial statements are fairly presented (or *give a true and fair view*) in accordance therewith.

---

[1] HKSA 570, "Going Concern."

[2] Where the auditor reports on more than one period, the auditor adjusts the date so that the letter pertains to all periods covered by the auditor's report.

[2a] The following additional management representations are applicable to audits of companies incorporated under the Companies Ordinance:

- We acknowledge that section 380 of the Companies Ordinance requires us to prepare financial statements which give a true and fair view of the financial position of the company as at the end of the financial year and of the financial performance of the company for the financial year.
- We are responsible for taking all reasonable steps to ensure the company keeps proper accounting records which are sufficient to show and explain the company's transactions, disclose with reasonable accuracy at any time the company's financial position and financial performance and to ensure that the financial statements comply with the Companies Ordinance.
- The financial statements comply with section 383 (Notes to Financial Statements to Contain Information on Directors' Emoluments etc) of the Companies Ordinance which must contain in the notes to the financial statements, the information prescribed by the Companies (Disclosure of Information about Benefits of Directors) Regulation (Cap. 622G).
- We are responsible for the preparation of the director's report that
  - (a) complies with sections 390 (Contents of Directors' Report: General) and 543(2) (Disclosure of Management Contract) and Schedule 5 (Contents of Directors' Report: Business Review) of the Companies Ordinance;
  - (b) contains the information prescribed by the regulations made under section 452(3) (Financial Secretary May Make Other Regulations) of the Companies Ordinance; and
  - (c) complies with other requirements prescribed by the regulations made under section 452 (3) of the Companies Ordinance.

- Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable. (HKSA 540)

- 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:

    - 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)

- 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).]

Management Management

HKSA 600

Issued September 2009; revised July 2010, May 2013, June 2014, February 2015*, August 2015**

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

Hong Kong Standard on Auditing 600

Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)

** Conforming amendments have been made to this HKSA as a result of the new and revised auditor reporting HKSAs issued in Update 172, and will become effective for audits of financial statements for periods ending on or after 15 December 2016. The conforming amendments are underlined for easy reference.

* Conforming amendments have been made to this HKSA as a result of HKSA 610 (Revised), *Using the Work of Internal Auditors*, and are effective for audits of financial statements for periods ended on or after 15 December 2013. The conforming amendments are set out in the Consolidated Table of Changes in Update 166 issued in February 2015.

* Conforming amendments have been made to this HKSA as a result of HKSA 610 (Revised 2013), *Using the Work of Internal Auditors*, and are effective for audits of financial statements for periods ended on or after 15 December 2014. The conforming amendments are set out in the Consolidated Table of Changes in Update 166 issued in February 2015.

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

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HONG KONG STANDARD ON AUDITING 600

SPECIAL CONSIDERATIONS—AUDITS OF GROUP FINANCIAL STATEMENTS (Including the Work of Component Auditors)

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

CONTENTS

Hong Kong Standard on Auditing (HKSA) 600, "Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)" 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. The Hong Kong Standards on Auditing (HKSAs) apply to group audits. This HKSA deals with special considerations that apply to group audits, in particular those that involve component auditors.

2. An auditor may find this HKSA, adapted as necessary in the circumstances, useful when that auditor involves other auditors in the audit of financial statements that are not group financial statements. For example, an auditor may involve another auditor to observe the inventory count or inspect physical fixed assets at a remote location.

3. A component auditor may be required by statute, regulation or for another reason, to express an audit opinion on the financial statements of a component. The group engagement team may decide to use the audit evidence on which the audit opinion on the financial statements of the component is based to provide audit evidence for the group audit, but the requirements of this HKSA nevertheless apply. (Ref: Para. A1)

4. In accordance with HKSA 220,[1] the group engagement partner is required to be satisfied that those performing the group audit engagement, including component auditors, collectively have the appropriate competence and capabilities. The group engagement partner is also responsible for the direction, supervision and performance of the group audit engagement.

5. The group engagement partner applies the requirements of HKSA 220 regardless of whether the group engagement team or a component auditor performs the work on the financial information of a component. This HKSA assists the group engagement partner to meet the requirements of HKSA 220 where component auditors perform work on the financial information of components.

6. Audit risk is a function of the risk of material misstatement of the financial statements and the risk that the auditor will not detect such misstatements.[2] In a group audit, this includes the risk that the component auditor may not detect a misstatement in the financial information of the component that could cause a material misstatement of the group financial statements, and the risk that the group engagement team may not detect this misstatement. This HKSA explains the matters that the group engagement team considers when determining the nature, timing and extent of its involvement in the risk assessment procedures and further audit procedures performed by the component auditors on the financial information of the components. The purpose of this involvement is to obtain sufficient appropriate audit evidence on which to base the audit opinion on the group financial statements.

Effective Date

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

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[1] HKSA 220, "Quality Control for an Audit of Financial Statements," paragraphs 14 and 15.

[2] HKSA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing," paragraph A32.

Objectives

8. The objectives of the auditor are:

   (a) To determine whether to act as the auditor of the group financial statements; and

   (b) If acting as the auditor of the group financial statements:

      (i) To communicate clearly with component auditors about the scope and timing of their work on financial information related to components and their findings; and

      (ii) To obtain sufficient appropriate audit evidence regarding the financial information of the components and the consolidation process to express an opinion on whether the group financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

Definitions

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

   (a) Component – An entity or business activity for which group or component management prepares financial information that should be included in the group financial statements. (Ref: Para. A2-A4)

   (b) Component auditor – An auditor who, at the request of the group engagement team, performs work on financial information related to a component for the group audit. (Ref: Para. A7)

   (c) Component management – Management responsible for the preparation of the financial information of a component.

   (d) Component materiality – The materiality for a component determined by the group engagement team.

   (e) Group – All the components whose financial information is included in the group financial statements. A group always has more than one component.

   (f) Group audit – The audit of group financial statements.

   (g) Group audit opinion – The audit opinion on the group financial statements.

   (h) Group engagement partner – The partner or other person in the firm who is responsible for the group audit engagement and its performance, and for the auditor's report on the group financial statements that is issued on behalf of the firm. Where joint auditors conduct the group audit, the joint engagement partners and their engagement teams collectively constitute the group engagement partner and the group engagement team. This HKSA does not, however, deal with the relationship between joint auditors or the work that one joint auditor performs in relation to the work of the other joint auditor.

   (i) Group engagement team – Partners, including the group engagement partner, and staff who establish the overall group audit strategy, communicate with component auditors, perform work on the consolidation process, and evaluate the conclusions drawn from the audit evidence as the basis for forming an opinion on the group financial statements.

(j) Group financial statements – Financial statements that include the financial information of more than one component. The term "group financial statements" also refers to combined financial statements aggregating the financial information prepared by components that have no parent but are under common control.

(k) Group management – Management responsible for the preparation of the group financial statements.

(l) Group-wide controls – Controls designed, implemented and maintained by group management over group financial reporting.

(m) Significant component – A component identified by the group engagement team (i) that is of individual financial significance to the group, or (ii) that, due to its specific nature or circumstances, is likely to include significant risks of material misstatement of the group financial statements. (Ref: Para. A5-A6)

10. Reference to "the applicable financial reporting framework" means the financial reporting framework that applies to the group financial statements. Reference to "the consolidation process" includes:

(a) The recognition, measurement, presentation, and disclosure of the financial information of the components in the group financial statements by way of consolidation, proportionate consolidation, or the equity or cost methods of accounting; and

(b) The aggregation in combined financial statements of the financial information of components that have no parent but are under common control.

Requirements

Responsibility

11. The group engagement partner is responsible for the direction, supervision and performance of the group audit engagement in compliance with professional standards and applicable legal and regulatory requirements, and whether the auditor's report that is issued is appropriate in the circumstances.[3] As a result, the auditor's report on the group financial statements shall not refer to a component auditor, unless required by law or regulation to include such reference. If such reference is required by law or regulation, the auditor's report shall indicate that the reference does not diminish the group engagement partner's or the group engagement partner's firm's responsibility for the group audit opinion. (Ref: Para. A8-A9)

Acceptance and Continuance

12. In applying HKSA 220, the group engagement partner shall determine whether sufficient appropriate audit evidence can reasonably be expected to be obtained in relation to the consolidation process and the financial information of the components on which to base the group audit opinion. For this purpose, the group engagement team shall obtain an understanding of the group, its components, and their environments that is sufficient to identify components that are likely to be significant components. Where component auditors will perform work on the financial information of such components, the group engagement partner shall evaluate whether the group engagement team will be able to be involved in the work of those component auditors to the extent necessary to obtain sufficient appropriate audit evidence. (Ref: Para. A10-A12)

[3] HKSA 220, paragraph 15.

13. If the group engagement partner concludes that:

    (a) it will not be possible for the group engagement team to obtain sufficient appropriate audit evidence due to restrictions imposed by group management; and

    (b) the possible effect of this inability will result in a disclaimer of opinion on the group financial statements,[4]

    the group engagement partner shall either:

    (a) in the case of a new engagement, not accept the engagement, or, in the case of a continuing engagement, withdraw from the engagement, where withdrawal is possible under applicable law or regulation; or

    (b) where law or regulation prohibits an auditor from declining an engagement or where withdrawal from an engagement is not otherwise possible, having performed the audit of the group financial statements to the extent possible, disclaim an opinion on the group financial statements. (Ref: Para. A13-A19)

Terms of Engagement

14. The group engagement partner shall agree on the terms of the group audit engagement in accordance with HKSA 210.[5] (Ref: Para. A20-A21)

Overall Audit Strategy and Audit Plan

15. The group engagement team shall establish an overall group audit strategy and shall develop a group audit plan in accordance with HKSA 300.[6]

16. The group engagement partner shall review the overall group audit strategy and group audit plan. (Ref: Para. A22)

Understanding the Group, Its Components, and Their Environments

17. The auditor is required to identify and assess the risks of material misstatement through obtaining an understanding of the entity and its environment.[7] The group engagement team shall:

    (a) Enhance its understanding of the group, its components, and their environments, including group-wide controls, obtained during the acceptance or continuance stage; and

    (b) Obtain an understanding of the consolidation process, including the instructions issued by group management to components. (Ref: Para. A23-A29)

18. The group engagement team shall obtain an understanding that is sufficient to:

    (a) Confirm or revise its initial identification of components that are likely to be significant; and

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

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

6 HKSA 300, "Planning an Audit of Financial Statements," paragraphs 7-12.

7 HKSA 315 (Revised), "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment."

(b) Assess the risks of material misstatement of the group financial statements, whether due to fraud or error.[8] (Ref: Para. A30-A31)

Understanding the Component Auditor

19. If the group engagement team plans to request a component auditor to perform work on the financial information of a component, the group engagement team shall obtain an understanding of the following: (Ref: Para. A32-A35)

(a) Whether the component auditor understands and will comply with the ethical requirements that are relevant to the group audit and, in particular, is independent. (Ref: Para. A37)

(b) The component auditor's professional competence. (Ref: Para. A38)

(c) Whether the group engagement team will be able to be involved in the work of the component auditor to the extent necessary to obtain sufficient appropriate audit evidence.

(d) Whether the component auditor operates in a regulatory environment that actively oversees auditors. (Ref: Para. A36)

20. If a component auditor does not meet the independence requirements that are relevant to the group audit, or the group engagement team has serious concerns about the other matters listed in paragraph 19(a)-(c), the group engagement team shall obtain sufficient appropriate audit evidence relating to the financial information of the component without requesting that component auditor to perform work on the financial information of that component. (Ref: Para. A39-A41)

Materiality

21. The group engagement team shall determine the following: (Ref: Para. A42)

(a) Materiality for the group financial statements as a whole when establishing the overall group audit strategy.

(b) If, in the specific circumstances of the group, there are particular classes of transactions, account balances or disclosures in the group financial statements for which misstatements of lesser amounts than materiality for the group financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the group financial statements, the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.

(c) Component materiality for those components where component auditors will perform an audit or a review for purposes of the group audit. To reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in the group financial statements exceeds materiality for the group financial statements as a whole, component materiality shall be lower than materiality for the group financial statements as a whole. (Ref: Para. A43-A44)

(d) The threshold above which misstatements cannot be regarded as clearly trivial to the group financial statements. (Ref: Para. A45)

8 HKSA 315 (Revised).

22. Where component auditors will perform an audit for purposes of the group audit, the group engagement team shall evaluate the appropriateness of performance materiality determined at the component level. (Ref: Para. A46)

23. If a component is subject to audit by statute, regulation or other reason, and the group engagement team decides to use that audit to provide audit evidence for the group audit, the group engagement team shall determine whether:

    (a) materiality for the component financial statements as a whole; and

    (b) performance materiality at the component level

    meet the requirements of this HKSA.

Responding to Assessed Risks

24. The auditor is required to design and implement appropriate responses to address the assessed risks of material misstatement of the financial statements.[9] The group engagement team shall determine the type of work to be performed by the group engagement team, or the component auditors on its behalf, on the financial information of the components (see paragraphs 26-29). The group engagement team shall also determine the nature, timing and extent of its involvement in the work of the component auditors (see paragraphs 30-31).

25. If the nature, timing and extent of the work to be performed on the consolidation process or the financial information of the components are based on an expectation that group-wide controls are operating effectively, or if substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level, the group engagement team shall test, or request a component auditor to test, the operating effectiveness of those controls.

Determining the Type of Work to Be Performed on the Financial Information of Components (Ref: Para. A47)

Significant Components

26. For a component that is significant due to its individual financial significance to the group, the group engagement team, or a component auditor on its behalf, shall perform an audit of the financial information of the component using component materiality.

27. For a component that is significant because it is likely to include significant risks of material misstatement of the group financial statements due to its specific nature or circumstances, the group engagement team, or a component auditor on its behalf, shall perform one or more of the following:

    (a) An audit of the financial information of the component using component materiality.

    (b) An audit of one or more account balances, classes of transactions or disclosures relating to the likely significant risks of material misstatement of the group financial statements. (Ref: Para. A48)

    (c) Specified audit procedures relating to the likely significant risks of material misstatement of the group financial statements. (Ref: Para. A49)

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

Components that Are Not Significant Components

28. For components that are not significant components, the group engagement team shall perform analytical procedures at group level. (Ref: Para. A50)

29. If the group engagement team does not consider that sufficient appropriate audit evidence on which to base the group audit opinion will be obtained from:

    (a) the work performed on the financial information of significant components;

    (b) the work performed on group-wide controls and the consolidation process; and

    (c) the analytical procedures performed at group level,

    the group engagement team shall select components that are not significant components and shall perform, or request a component auditor to perform, one or more of the following on the financial information of the individual components selected: (Ref: Para. A51-A53)

    - An audit of the financial information of the component using component materiality.
    - An audit of one or more account balances, classes of transactions or disclosures.
    - A review of the financial information of the component using component materiality.
    - Specified procedures.

    The group engagement team shall vary the selection of components over a period of time.

Involvement in the Work Performed by Component Auditors (Ref: Para. A54-A55)

Significant Components—Risk Assessment

30. If a component auditor performs an audit of the financial information of a significant component, the group engagement team shall be involved in the component auditor's risk assessment to identify significant risks of material misstatement of the group financial statements. The nature, timing and extent of this involvement are affected by the group engagement team's understanding of the component auditor, but at a minimum shall include:

    (a) Discussing with the component auditor or component management those of the component's business activities that are significant to the group;

    (b) Discussing with the component auditor the susceptibility of the component to material misstatement of the financial information due to fraud or error; and

    (c) Reviewing the component auditor's documentation of identified significant risks of material misstatement of the group financial statements. Such documentation may take the form of a memorandum that reflects the component auditor's conclusion with regard to the identified significant risks.

Identified Significant Risks of Material Misstatement of the Group Financial Statements—Further Audit Procedures

31. If significant risks of material misstatement of the group financial statements have been identified in a component on which a component auditor performs the work, the group engagement team shall evaluate the appropriateness of the further audit procedures to be performed to respond to the identified significant risks of material misstatement of the group financial statements. Based on its understanding of the component auditor, the group

engagement team shall determine whether it is necessary to be involved in the further audit procedures.

Consolidation Process

32. In accordance with paragraph 17, the group engagement team obtains an understanding of group-wide controls and the consolidation process, including the instructions issued by group management to components. In accordance with paragraph 25, the group engagement team, or component auditor at the request of the group engagement team, tests the operating effectiveness of group-wide controls if the nature, timing and extent of the work to be performed on the consolidation process are based on an expectation that group-wide controls are operating effectively, or if substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level.

33. The group engagement team shall design and perform further audit procedures on the consolidation process to respond to the assessed risks of material misstatement of the group financial statements arising from the consolidation process. This shall include evaluating whether all components have been included in the group financial statements.

34. The group engagement team shall evaluate the appropriateness, completeness and accuracy of consolidation adjustments and reclassifications, and shall evaluate whether any fraud risk factors or indicators of possible management bias exist. (Ref: Para. A56)

35. If the financial information of a component has not been prepared in accordance with the same accounting policies applied to the group financial statements, the group engagement team shall evaluate whether the financial information of that component has been appropriately adjusted for purposes of preparing and presenting the group financial statements.

36. The group engagement team shall determine whether the financial information identified in the component auditor's communication (see paragraph 41(c)) is the financial information that is incorporated in the group financial statements.

37. If the group financial statements include the financial statements of a component with a financial reporting period-end that differs from that of the group, the group engagement team shall evaluate whether appropriate adjustments have been made to those financial statements in accordance with the applicable financial reporting framework.

Subsequent Events

38. Where the group engagement team or component auditors perform audits on the financial information of components, the group engagement team or the component auditors shall perform procedures designed to identify events at those components that occur between the dates of the financial information of the components and the date of the auditor's report on the group financial statements, and that may require adjustment to or disclosure in the group financial statements.

39. Where component auditors perform work other than audits of the financial information of components, the group engagement team shall request the component auditors to notify the group engagement team if they become aware of subsequent events that may require an adjustment to or disclosure in the group financial statements.

Communication with the Component Auditor

40. The group engagement team shall communicate its requirements to the component auditor on a timely basis. This communication shall set out the work to be performed, the use to be made of that work, and the form and content of the component auditor's communication with the group engagement team. It shall also include the following: (Ref: Para. A57, A58, A60)

(a) A request that the component auditor, knowing the context in which the group engagement team will use the work of the component auditor, confirms that the component auditor will cooperate with the group engagement team. (Ref: Para. A59)

(b) The ethical requirements that are relevant to the group audit and, in particular, the independence requirements.

(c) In the case of an audit or review of the financial information of the component, component materiality (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) and the threshold above which misstatements cannot be regarded as clearly trivial to the group financial statements.

(d) Identified significant risks of material misstatement of the group financial statements, due to fraud or error, that are relevant to the work of the component auditor. The group engagement team shall request the component auditor to communicate on a timely basis any other identified significant risks of material misstatement of the group financial statements, due to fraud or error, in the component, and the component auditor's responses to such risks.

(e) A list of related parties prepared by group management, and any other related parties of which the group engagement team is aware. The group engagement team shall request the component auditor to communicate on a timely basis related parties not previously identified by group management or the group engagement team. The group engagement team shall determine whether to identify such additional related parties to other component auditors.

41. The group engagement team shall request the component auditor to communicate matters relevant to the group engagement team's conclusion with regard to the group audit. Such communication shall include: (Ref: Para. A60)

(a) Whether the component auditor has complied with ethical requirements that are relevant to the group audit, including independence and professional competence;

(b) Whether the component auditor has complied with the group engagement team's requirements;

(c) Identification of the financial information of the component on which the component auditor is reporting;

(d) Information on instances of non-compliance with laws or regulations that could give rise to a material misstatement of the group financial statements;

(e) A list of uncorrected misstatements of the financial information of the component (the list need not include misstatements that are below the threshold for clearly trivial misstatements communicated by the group engagement team (see paragraph 40(c));

(f) Indicators of possible management bias;

(g) Description of any identified significant deficiencies in internal control at the component level;

(h) Other significant matters that the component auditor communicated or expects to communicate to those charged with governance of the component, including fraud or suspected fraud involving component management, employees who have significant roles in internal control at the component level or others where the fraud resulted in a material misstatement of the financial information of the component;

(i) Any other matters that may be relevant to the group audit, or that the component auditor wishes to draw to the attention of the group engagement team, including exceptions noted in the written representations that the component auditor requested from component management; and

(j) The component auditor's overall findings, conclusions or opinion.

Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained

Evaluating the Component Auditor's Communication and Adequacy of their Work

42. The group engagement team shall evaluate the component auditor's communication (see paragraph 41). The group engagement team shall:

(a) Discuss significant matters arising from that evaluation with the component auditor, component management or group management, as appropriate; and

(b) Determine whether it is necessary to review other relevant parts of the component auditor's audit documentation. (Ref: Para. A61)

43. If the group engagement team concludes that the work of the component auditor is insufficient, the group engagement team shall determine what additional procedures are to be performed, and whether they are to be performed by the component auditor or by the group engagement team.

Sufficiency and Appropriateness of Audit Evidence

44. The auditor is required to obtain sufficient appropriate audit evidence 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.[10] The group engagement team shall evaluate whether sufficient appropriate audit evidence has been obtained from the audit procedures performed on the consolidation process and the work performed by the group engagement team and the component auditors on the financial information of the components, on which to base the group audit opinion. (Ref: Para. A62)

45. The group engagement partner shall evaluate the effect on the group audit opinion of any uncorrected misstatements (either identified by the group engagement team or communicated by component auditors) and any instances where there has been an inability to obtain sufficient appropriate audit evidence. (Ref: Para. A63)

Communication with Group Management and Those Charged with Governance of the Group

Communication with Group Management

46. The group engagement team shall determine which identified deficiencies in internal control to communicate to those charged with governance and group management in accordance with HKSA 265.[11] In making this determination, the group engagement team shall consider:

(a) Deficiencies in group-wide internal control that the group engagement team has identified;

(b) Deficiencies in internal control that the group engagement team has identified in internal controls at components; and

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[10] HKSA 200, paragraph 17.

[11] HKSA 265, "Communicating Deficiencies in Internal Control to Those Charged with Governance and Management."

(c) Deficiencies in internal control that component auditors have brought to the attention of the group engagement team.

47. If fraud has been identified by the group engagement team or brought to its attention by a component auditor (see paragraph 41(h)), or information indicates that a fraud may exist, the group engagement team shall communicate this on a timely basis to the appropriate level of group management in order to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities. (Ref. Para. A64)

48. A component auditor may be required by statute, regulation or for another reason, to express an audit opinion on the financial statements of a component. In that case, the group engagement team shall request group management to inform component management of any matter of which the group engagement team becomes aware that may be significant to the financial statements of the component, but of which component management may be unaware. If group management refuses to communicate the matter to component management, the group engagement team shall discuss the matter with those charged with governance of the group. If the matter remains unresolved, the group engagement team, subject to legal and professional confidentiality considerations, shall consider whether to advise the component auditor not to issue the auditor's report on the financial statements of the component until the matter is resolved. (Ref: Para. A65)

Communication with Those Charged with Governance of the Group

49. The group engagement team shall communicate the following matters with those charged with governance of the group, in addition to those required by HKSA 260 [12] and other HKSAs: (Ref: Para. A66)

(a) An overview of the type of work to be performed on the financial information of the components.

(b) An overview of the nature of the group engagement team's planned involvement in the work to be performed by the component auditors on the financial information of significant components.

(c) Instances where the group engagement team's evaluation of the work of a component auditor gave rise to a concern about the quality of that auditor's work.

(d) Any limitations on the group audit, for example, where the group engagement team's access to information may have been restricted.

(e) Fraud or suspected fraud involving group management, component management, employees who have significant roles in group-wide controls or others where the fraud resulted in a material misstatement of the group financial statements.

Documentation

50. The group engagement team shall include in the audit documentation the following matters:[13]

(a) An analysis of components, indicating those that are significant, and the type of work performed on the financial information of the components.

12 HKSA 260, "Communication with Those Charged with Governance."

13 HKSA 230, "Audit Documentation," paragraphs 8-11, and A6.

(b) The nature, timing and extent of the group engagement team's involvement in the work performed by the component auditors on significant components including, where applicable, the group engagement team's review of relevant parts of the component auditors' audit documentation and conclusions thereon.

(c) Written communications between the group engagement team and the component auditors about the group engagement team's requirements.

Conformity and Compliance with International Standards on Auditing

51. As of September 2009 (date of issue), this HKSA conforms with International Standard on Auditing (ISA) 600 (Revised and Redrafted) "Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)". Compliance with the requirements of this HKSA ensures compliance with ISA 600 (Revised and Redrafted).

52. Additional local explanation is provided in footnote 23a, Appendices 1 and 6.

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Application and Other Explanatory Material

Components Subject to Audit by Statute, Regulation or Other Reason (Ref: Para. 3)

A1. Factors that may affect the group engagement team's decision whether to use an audit required by statute, regulation or for another reason to provide audit evidence for the group audit include the following:

- Differences in the financial reporting framework applied in preparing the financial statements of the component and that applied in preparing the group financial statements.

- Differences in the auditing and other standards applied by the component auditor and those applied in the audit of the group financial statements.

- Whether the audit of the financial statements of the component will be completed in time to meet the group reporting timetable.

Definitions

Component (Ref: Para. 9(a))

A2. The structure of a group affects how components are identified. For example, the group financial reporting system may be based on an organizational structure that provides for financial information to be prepared by a parent and one or more subsidiaries, joint ventures, or investees accounted for by the equity or cost methods of accounting; by a head office and one or more divisions or branches; or by a combination of both. Some groups, however, may organize their financial reporting system by function, process, product or service (or by groups of products or services), or geographic locations. In these cases, the entity or business activity for which group or component management prepares financial information that is included in the group financial statements may be a function, process, product or service (or group of products or services), or geographic location.

A3. Various levels of components may exist within the group financial reporting system, in which case it may be more appropriate to identify components at certain levels of aggregation rather than individually.

A4. Components aggregated at a certain level may constitute a component for purposes of the group audit; however, such a component may also prepare group financial statements that incorporate the financial information of the components it encompasses (that is, a subgroup). This HKSA may therefore be applied by different group engagement partners and teams for different subgroups within a larger group.

Significant Component (Ref: Para. 9(m))

A5. As the individual financial significance of a component increases, the risks of material misstatement of the group financial statements ordinarily increase. The group engagement team may apply a percentage to a chosen benchmark as an aid to identify components that are of individual financial significance. Identifying a benchmark and determining a percentage to be applied to it involve the exercise of professional judgment. Depending on the nature and circumstances of the group, appropriate benchmarks might include group assets, liabilities, cash flows, profit or turnover. For example, the group engagement team may consider that components exceeding 15% of the chosen benchmark are significant components. A higher or lower percentage may, however, be deemed appropriate in the circumstances.

A6. The group engagement team may also identify a component as likely to include significant risks of material misstatement of the group financial statements due to its specific nature or circumstances (that is, risks that require special audit consideration[14]). For example, a component could be responsible for foreign exchange trading and thus expose the group to a significant risk of material misstatement, even though the component is not otherwise of individual financial significance to the group.

Component Auditor (Ref: Para. 9(b))

A7. A member of the group engagement team may perform work on the financial information of a component for the group audit at the request of the group engagement team. Where this is the case, such a member of the engagement team is also a component auditor.

Responsibility (Ref: Para. 11)

A8. Although component auditors may perform work on the financial information of the components for the group audit and as such are responsible for their overall findings, conclusions or opinions, the group engagement partner or the group engagement partner's firm is responsible for the group audit opinion.

A9. When the group audit opinion is modified because the group engagement team was unable to obtain sufficient appropriate audit evidence in relation to the financial information of one or more components, the Basis for Modification paragraph in the auditor's report on the group financial statements describes the reasons for that inability without referring to the component auditor, unless such a reference is necessary for an adequate explanation of the circumstances.[15]

Acceptance and Continuance

Obtaining an Understanding at the Acceptance or Continuance Stage (Ref: Para. 12)

A10. In the case of a new engagement, the group engagement team's understanding of the group, its components, and their environments may be obtained from:

- Information provided by group management;

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[14] HKSA 315 (Revised), paragraphs 27-29.

[15] HKSA 705, paragraph 20.

- Communication with group management; and
- Where applicable, communication with the previous group engagement team, component management, or component auditors.

A11. The group engagement team's understanding may include matters such as the following:

- The group structure, including both the legal and organizational structure (that is, how the group financial reporting system is organized).
- Components' business activities that are significant to the group, including the industry and regulatory, economic and political environments in which those activities take place.
- The use of service organizations, including shared service centers.
- A description of group-wide controls.
- The complexity of the consolidation process.
- Whether component auditors that are not from the group engagement partner's firm or network will perform work on the financial information of any of the components, and group management's rationale for appointing more than one auditor.
- Whether the group engagement team:
    - Will have unrestricted access to those charged with governance of the group, group management, those charged with governance of the component, component management, component information, and the component auditors (including relevant audit documentation sought by the group engagement team); and
    - Will be able to perform necessary work on the financial information of the components.

A12. In the case of a continuing engagement, the group engagement team's ability to obtain sufficient appropriate audit evidence may be affected by significant changes, for example:

- Changes in the group structure (for example, acquisitions, disposals, reorganizations, or changes in how the group financial reporting system is organized).
- Changes in components' business activities that are significant to the group.
- Changes in the composition of those charged with governance of the group, group management, or key management of significant components.
- Concerns the group engagement team has with regard to the integrity and competence of group or component management.
- Changes in group-wide controls.
- Changes in the applicable financial reporting framework.

Expectation to Obtain Sufficient Appropriate Audit Evidence (Ref: Para. 13)

A13. A group may consist only of components not considered significant components. In these circumstances, the group engagement partner can reasonably expect to obtain sufficient appropriate audit evidence on which to base the group audit opinion if the group engagement team will be able to:

(a) Perform the work on the financial information of some of these components; and

(b) Be involved in the work performed by component auditors on the financial information of other components to the extent necessary to obtain sufficient appropriate audit evidence.

Access to Information (Ref: Para. 13)

A14. The group engagement team's access to information may be restricted by circumstances that cannot be overcome by group management, for example laws relating to confidentiality and data privacy, or denial by the component auditor of access to relevant audit documentation sought by the group engagement team. It may also be restricted by group management.

A15. Where access to information is restricted by circumstances, the group engagement team may still be able to obtain sufficient appropriate audit evidence; however, this is less likely as the significance of the component increases. For example, the group engagement team may not have access to those charged with governance, management, or the auditor (including relevant audit documentation sought by the group engagement team) of a component that is accounted for by the equity method of accounting. If the component is not a significant component, and the group engagement team has a complete set of financial statements of the component, including the auditor's report thereon, and has access to information kept by group management in relation to that component, the group engagement team may conclude that this information constitutes sufficient appropriate audit evidence in relation to that component. If the component is a significant component, however, the group engagement team will not be able to comply with the requirements of this HKSA relevant in the circumstances of the group audit. For example, the group engagement team will not be able to comply with the requirement in paragraphs 30-31 to be involved in the work of the component auditor. The group engagement team will not, therefore, be able to obtain sufficient appropriate audit evidence in relation to that component. The effect of the group engagement team's inability to obtain sufficient appropriate audit evidence is considered in terms of HKSA 705.

A16. The group engagement team will not be able to obtain sufficient appropriate audit evidence if group management restricts the access of the group engagement team or a component auditor to the information of a significant component.

A17. Although the group engagement team may be able to obtain sufficient appropriate audit evidence if such restriction relates to a component considered not a significant component, the reason for the restriction may affect the group audit opinion. For example, it may affect the reliability of group management's responses to the group engagement team's inquiries and group management's representations to the group engagement team.

A18. Law or regulation may prohibit the group engagement partner from declining or withdrawing from an engagement. For example, in some jurisdictions the auditor is appointed for a specified period of time and is prohibited from withdrawing before the end of that period. Also, in the public sector, the option of declining or withdrawing from an engagement may not be available to the auditor due to the nature of the mandate or public interest considerations. In these circumstances, this HKSA still applies to the group audit, and the effect of the group engagement team's inability to obtain sufficient appropriate audit evidence is considered in terms of HKSA 705.

A19. Appendix 1 contains an example of an auditor's report containing a qualified opinion based on the group engagement team's inability to obtain sufficient appropriate audit evidence in relation to a significant component accounted for by the equity method of accounting, but where, in the group engagement team's judgment, the effect is material but not pervasive.

Terms of Engagement (Ref: Para. 14)

A20. The terms of engagement identify the applicable financial reporting framework.[16] Additional matters may be included in the terms of a group audit engagement, such as the fact that:

- The communication between the group engagement team and the component auditors should be unrestricted to the extent possible under law or regulation;
- Important communications between the component auditors, those charged with governance of the component, and component management, including communications on significant deficiencies in internal control, should be communicated as well to the group engagement team;
- Important communications between regulatory authorities and components related to financial reporting matters should be communicated to the group engagement team; and
- To the extent the group engagement team considers necessary, it should be permitted:
    - Access to component information, those charged with governance of components, component management, and the component auditors (including relevant audit documentation sought by the group engagement team); and
    - To perform work or request a component auditor to perform work on the financial information of the components.

A21. Restrictions imposed on:

- the group engagement team's access to component information, those charged with governance of components, component management, or the component auditors (including relevant audit documentation sought by the group engagement team); or
- the work to be performed on the financial information of the components,

after the group engagement partner's acceptance of the group audit engagement, constitute an inability to obtain sufficient appropriate audit evidence that may affect the group audit opinion. In exceptional circumstances it may even lead to withdrawal from the engagement where withdrawal is possible under applicable law or regulation.

Overall Audit Strategy and Audit Plan (Ref: Para. 16)

A22. The group engagement partner's review of the overall group audit strategy and group audit plan is an important part of fulfilling the group engagement partner's responsibility for the direction of the group audit engagement.

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[16] HKSA 210, paragraph 8.

Understanding the Group, Its Components, and Their Environments

Matters about Which the Group Engagement Team Obtains an Understanding (Ref: Para. 17)

A23. HKSA 315 (Revised) contains guidance on matters the auditor may consider when obtaining an understanding of the industry, regulatory, and other external factors that affect the entity, including the applicable financial reporting framework; the nature of the entity; objectives and strategies and related business risks; and measurement and review of the entity's financial performance.[17] Appendix 2 of this HKSA contains guidance on matters specific to a group, including the consolidation process.

Instructions Issued by Group Management to Components (Ref: Para. 17)

A24. To achieve uniformity and comparability of financial information, group management ordinarily issues instructions to components. Such instructions specify the requirements for financial information of the components to be included in the group financial statements and often include financial reporting procedures manuals and a reporting package. A reporting package ordinarily consists of standard formats for providing financial information for incorporation in the group financial statements. Reporting packages generally do not, however, take the form of complete financial statements prepared and presented in accordance with the applicable financial reporting framework.

A25. The instructions ordinarily cover:

- The accounting policies to be applied;
- Statutory and other disclosure requirements applicable to the group financial statements, including:
  - The identification and reporting of segments;
  - Related party relationships and transactions;
  - Intra-group transactions and unrealized profits;
  - Intra-group account balances; and
- A reporting timetable.

A26. The group engagement team's understanding of the instructions may include the following:

- The clarity and practicality of the instructions for completing the reporting package.
- Whether the instructions:
  - Adequately describe the characteristics of the applicable financial reporting framework;
  - Provide for disclosures that are sufficient to comply with the requirements of the applicable financial reporting framework, for example disclosure of related party relationships and transactions, and segment information;
  - Provide for the identification of consolidation adjustments, for example intra-group transactions and unrealized profits, and intra-group account balances; and

[17] HKSA 315 (Revised), paragraphs A24-A48.

  - Provide for the approval of the financial information by component management.

Fraud (Ref: Para. 17)

A27. The auditor is required to identify and assess the risks of material misstatement of the financial statements due to fraud, and to design and implement appropriate responses to the assessed risks.[18] Information used to identify the risks of material misstatement of the group financial statements due to fraud may include the following:

- Group management's assessment of the risks that the group financial statements may be materially misstated as a result of fraud.
- Group management's process for identifying and responding to the risks of fraud in the group, including any specific fraud risks identified by group management, or account balances, classes of transactions, or disclosures for which a risk of fraud is likely.
- Whether there are particular components for which a risk of fraud is likely.
- How those charged with governance of the group monitor group management's processes for identifying and responding to the risks of fraud in the group, and the controls group management has established to mitigate these risks.
- Responses of those charged with governance of the group, group management, appropriate individuals within the internal audit function (and if considered appropriate, component management, the component auditors, and others) to the group engagement team's inquiry whether they have knowledge of any actual, suspected, or alleged fraud affecting a component or the group.

Discussion among Group Engagement Team Members and Component Auditors Regarding the Risks of Material Misstatement of the Group Financial Statements, Including Risks of Fraud (Ref: Para. 17)

A28. The key members of the engagement team are required to discuss the susceptibility of an entity to material misstatement of the financial statements due to fraud or error, specifically emphasizing the risks due to fraud. In a group audit, these discussions may also include the component auditors.[19] The group engagement partner's determination of who to include in the discussions, how and when they occur, and their extent, is affected by factors such as prior experience with the group.

A29. The discussions provide an opportunity to:

- Share knowledge of the components and their environments, including group-wide controls.
- Exchange information about the business risks of the components or the group.
- Exchange ideas about how and where the group financial statements may be susceptible to material misstatement due to fraud or error, how group management and component management could perpetrate and conceal fraudulent financial reporting, and how assets of the components could be misappropriated.

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

19 HKSA 240, paragraph 15; HKSA 315 (Revised), paragraph 10.

- Identify practices followed by group or component management that may be biased or designed to manage earnings that could lead to fraudulent financial reporting, for example, revenue recognition practices that do not comply with the applicable financial reporting framework.

- Consider known external and internal factors affecting the group that may create an incentive or pressure for group management, component management, or others to commit fraud, provide the opportunity for fraud to be perpetrated, or indicate a culture or environment that enables group management, component management, or others to rationalize committing fraud.

- Consider the risk that group or component management may override controls.

- Consider whether uniform accounting policies are used to prepare the financial information of the components for the group financial statements and, where not, how differences in accounting policies are identified and adjusted (where required by the applicable financial reporting framework).

- Discuss fraud that has been identified in components, or information that indicates existence of a fraud in a component.

- Share information that may indicate non-compliance with national laws or regulations, for example, payments of bribes and improper transfer pricing practices.

Risk Factors (Ref: Para. 18)

A30. Appendix 3 sets out examples of conditions or events that, individually or together, may indicate risks of material misstatement of the group financial statements, including risks due to fraud.

Risk Assessment (Ref: Para. 18)

A31. The group engagement team's assessment at group level of the risks of material misstatement of the group financial statements is based on information such as the following:

- Information obtained from the understanding of the group, its components, and their environments, and of the consolidation process, including audit evidence obtained in evaluating the design and implementation of group-wide controls and controls that are relevant to the consolidation.

- Information obtained from the component auditors.

Understanding the Component Auditor (Ref: Para. 19)

A32. The group engagement team obtains an understanding of a component auditor only when it plans to request the component auditor to perform work on the financial information of a component for the group audit. For example, it will not be necessary to obtain an understanding of the auditors of those components for which the group engagement team plans to perform analytical procedures at group level only.

Group Engagement Team's Procedures to Obtain an Understanding of the Component Auditor and Sources of Audit Evidence (Ref: Para. 19)

A33. The nature, timing and extent of the group engagement team's procedures to obtain an understanding of the component auditor are affected by factors such as previous experience with or knowledge of the component auditor, and the degree to which the group engagement team and the component auditor are subject to common policies and procedures, for example:

- Whether the group engagement team and a component auditor share:
  - Common policies and procedures for performing the work (for example, audit methodologies);
  - Common quality control policies and procedures; or
  - Common monitoring policies and procedures.
- The consistency or similarity of:
  - Laws and regulations or legal system;
  - Professional oversight, discipline, and external quality assurance;
  - Education and training;
  - Professional organizations and standards;
  - Language and culture.

A34. These factors interact and are not mutually exclusive. For example, the extent of the group engagement team's procedures to obtain an understanding of Component Auditor A, who consistently applies common quality control and monitoring policies and procedures and a common audit methodology or operates in the same jurisdiction as the group engagement partner, may be less than the extent of the group engagement team's procedures to obtain an understanding of Component Auditor B, who is not consistently applying common quality control and monitoring policies and procedures and a common audit methodology or operates in a foreign jurisdiction. The nature of the procedures performed in relation to Component Auditors A and B may also be different.

A35. The group engagement team may obtain an understanding of the component auditor in a number of ways. In the first year of involving a component auditor, the group engagement team may, for example:

- Evaluate the results of the quality control monitoring system where the group engagement team and component auditor are from a firm or network that operates under and complies with common monitoring policies and procedures;[20]
- Visit the component auditor to discuss the matters in paragraph 19(a)-(c);
- Request the component auditor to confirm the matters referred to in paragraph 19(a)-(c) in writing. Appendix 4 contains an example of written confirmations by a component auditor;
- Request the component auditor to complete questionnaires about the matters in paragraph 19(a)-(c);
- Discuss the component auditor with colleagues in the group engagement partner's firm, or with a reputable third party that has knowledge of the component auditor; or

[20] As required by Hong Kong Standard on Quality Control (HKSQC 1), "Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements," paragraph 54, or national requirements that are at least as demanding.

- Obtain confirmations from the professional body or bodies to which the component auditor belongs, the authorities by which the component auditor is licensed, or other third parties.

In subsequent years, the understanding of the component auditor may be based on the group engagement team's previous experience with the component auditor. The group engagement team may request the component auditor to confirm whether anything in relation to the matters listed in paragraph 19(a)-(c) has changed since the previous year.

A36. Where independent oversight bodies have been established to oversee the auditing profession and monitor the quality of audits, awareness of the regulatory environment may assist the group engagement team in evaluating the independence and competence of the component auditor. Information about the regulatory environment may be obtained from the component auditor or information provided by the independent oversight bodies.

Ethical Requirements that Are Relevant to the Group Audit (Ref: Para. 19(a))

A37. When performing work on the financial information of a component for a group audit, the component auditor is subject to ethical requirements that are relevant to the group audit. Such requirements may be different or in addition to those applying to the component auditor when performing a statutory audit in the component auditor's jurisdiction. The group engagement team therefore obtains an understanding whether the component auditor understands and will comply with the ethical requirements that are relevant to the group audit, sufficient to fulfill the component auditor's responsibilities in the group audit.

The Component Auditor's Professional Competence (Ref: Para. 19(b))

A38. The group engagement team's understanding of the component auditor's professional competence may include whether the component auditor:

- Possesses an understanding of auditing and other standards applicable to the group audit that is sufficient to fulfill the component auditor's responsibilities in the group audit;
- Possesses the special skills (for example, industry specific knowledge) necessary to perform the work on the financial information of the particular component; and
- Where relevant, possesses an understanding of the applicable financial reporting framework that is sufficient to fulfill the component auditor's responsibilities in the group audit (instructions issued by group management to components often describe the characteristics of the applicable financial reporting framework).

Application of the Group Engagement Team's Understanding of a Component Auditor (Ref: Para. 20)

A39. The group engagement team cannot overcome the fact that a component auditor is not independent by being involved in the work of the component auditor or by performing additional risk assessment or further audit procedures on the financial information of the component.

A40. However, the group engagement team may be able to overcome less than serious concerns about the component auditor's professional competency (for example, lack of industry specific knowledge), or the fact that the component auditor does not operate in an environment that actively oversees auditors, by being involved in the work of the component auditor or by performing additional risk assessment or further audit procedures on the financial information of the component.

A41. Where law or regulation prohibits access to relevant parts of the audit documentation of the component auditor, the group engagement team may request the component auditor to overcome this by preparing a memorandum that covers the relevant information.

Materiality (Ref: Para. 21-23)

A42. The auditor is required:[21]

(a) When establishing the overall audit strategy, to determine:

(i) Materiality for the financial statements as a whole; and

(ii) If, in the specific circumstances of the entity, there are particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures; and

(b) To determine performance materiality.

In the context of a group audit, materiality is established for both the group financial statements as a whole, and for the financial information of the components. Materiality for the group financial statements as a whole is used when establishing the overall group audit strategy.

A43. To reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in the group financial statements exceeds materiality for the group financial statements as a whole, component materiality is set lower than materiality for the group financial statements as a whole. Different component materiality may be established for different components. Component materiality need not be an arithmetical portion of the materiality for the group financial statements as a whole and, consequently, the aggregate of component materiality for the different components may exceed the materiality for the group financial statements as a whole. Component materiality is used when establishing the overall audit strategy for a component.

A44. Component materiality is determined for those components whose financial information will be audited or reviewed as part of the group audit in accordance with paragraphs 26, 27(a) and 29. Component materiality is used by the component auditor to evaluate whether uncorrected detected misstatements are material, individually or in the aggregate.

A45. A threshold for misstatements is determined in addition to component materiality. Misstatements identified in the financial information of the component that are above the threshold for misstatements are communicated to the group engagement team.

A46. In the case of an audit of the financial information of a component, the component auditor (or group engagement team) determines performance materiality at the component level. This is necessary to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in the financial information of the component exceeds component materiality. In practice, the group engagement team may set component materiality at this lower level. Where this is the case, the component auditor uses component materiality for purposes of assessing the risks of material misstatement of the financial information of the component and to design further audit procedures in response to assessed risks as well as for evaluating whether detected misstatements are material individually or in the aggregate.

[21] HKSA 320, "Materiality in Planning and Performing an Audit," paragraphs 10-11.

Responding to Assessed Risks

Determining the Type of Work to Be Performed on the Financial Information of Components
(Ref: Para. 26-27)

A47. The group engagement team's determination of the type of work to be performed on the financial information of a component and its involvement in the work of the component auditor is affected by:

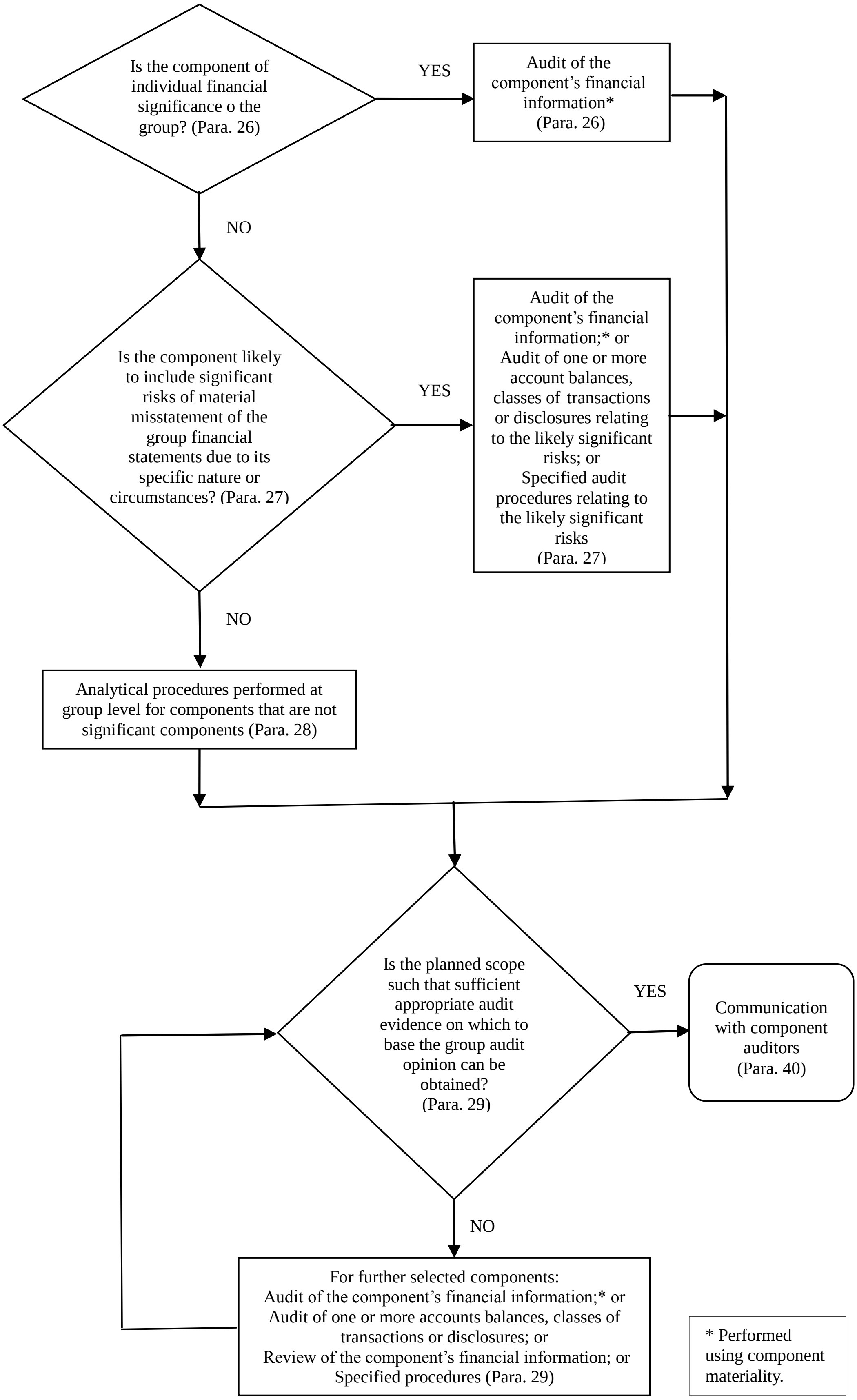
(a) The significance of the component;

(b) The identified significant risks of material misstatement of the group financial statements;

(c) The group engagement team's evaluation of the design of group-wide controls and determination whether they have been implemented; and

(d) The group engagement team's understanding of the component auditor.

The diagram shows how the significance of the component affects the group engagement team's determination of the type of work to be performed on the financial information of the component.


Is the component of individual financial significance o the group? (Para. 26)
YES
Audit of the component's financial information* (Para. 26)
NO
Is the component likely to include significant risks of material misstatement of the group financial statements due to its specific nature or circumstances? (Para. 27)
YES
Audit of the component's financial information;* or Audit of one or more account balances, classes of transactions or disclosures relating to the likely significant risks; or Specified audit procedures relating to the likely significant risks (Para. 27)
NO
Analytical procedures performed at group level for components that are not significant components (Para. 28)
Is the planned scope such that sufficient appropriate audit evidence on which to base the group audit opinion can be obtained? (Para. 29)
YES
Communication with component auditors (Para. 40)
NO
For further selected components: Audit of the component's financial information;* or Audit of one or more accounts balances, classes of transactions or disclosures; or Review of the component's financial information; or Specified procedures (Para. 29)
* Performed using component materiality.

Significant Components (Ref: Para. 27(b)-(c))

A48. The group engagement team may identify a component as a significant component because that component is likely to include significant risks of material misstatement of the group financial statements due to its specific nature or circumstances. In that case, the group engagement team may be able to identify the account balances, classes of transactions or disclosures affected by the likely significant risks. Where this is the case, the group engagement team may decide to perform, or request a component auditor to perform, an audit of only those account balances, classes of transactions or disclosures. For example, in the situation described in paragraph A6, the work on the financial information of the component may be limited to an audit of the account balances, classes of transactions and disclosures affected by the foreign exchange trading of that component. Where the group engagement team requests a component auditor to perform an audit of one or more specific account balances, classes of transactions or disclosures, the communication of the group engagement team (see paragraph 40) takes account of the fact that many financial statement items are interrelated.

A49. The group engagement team may design audit procedures that respond to a likely significant risk of material misstatement of the group financial statements. For example, in the case of a likely significant risk of inventory obsolescence, the group engagement team may perform, or request a component auditor to perform, specified audit procedures on the valuation of inventory at a component that holds a large volume of potentially obsolete inventory, but that is not otherwise significant.

Components that Are Not Significant Components (Ref: Para. 28-29)

A50. Depending on the circumstances of the engagement, the financial information of the components may be aggregated at various levels for purposes of the analytical procedures. The results of the analytical procedures corroborate the group engagement team's conclusions that there are no significant risks of material misstatement of the aggregated financial information of components that are not significant components.

A51. The group engagement team's decision as to how many components to select in accordance with paragraph 29, which components to select, and the type of work to be performed on the financial information of the individual components selected may be affected by factors such as the following:

- The extent of audit evidence expected to be obtained on the financial information of the significant components.
- Whether the component has been newly formed or acquired.
- Whether significant changes have taken place in the component.
- Whether the internal audit function has performed work at the component and any effect of that work on the group audit.
- Whether the components apply common systems and processes.
- The operating effectiveness of group-wide controls.
- Abnormal fluctuations identified by analytical procedures performed at group level.
- The individual financial significance of, or the risk posed by, the component in comparison with other components within this category.
- Whether the component is subject to audit required by statute, regulation or for another reason.

Including an element of unpredictability in selecting components in this category may increase the likelihood of identifying material misstatement of the components' financial information. The selection of components is often varied on a cyclical basis.

A52. A review of the financial information of a component may be performed in accordance with Hong Kong Standard on Review Engagements (HKSRE) 2400 [22] or HKSRE 2410,[23] adapted as necessary in the circumstances. The group engagement team may also specify additional procedures to supplement this work.

A53. As explained in paragraph A13, a group may consist only of components that are not significant components. In these circumstances, the group engagement team can obtain sufficient appropriate audit evidence on which to base the group audit opinion by determining the type of work to be performed on the financial information of the components in accordance with paragraph 29. It is unlikely that the group engagement team will obtain sufficient appropriate audit evidence on which to base the group audit opinion if the group engagement team, or a component auditor, only tests group-wide controls and performs analytical procedures on the financial information of the components.

Involvement in the Work Performed by Component Auditors (Ref: Para. 30-31)

A54. Factors that may affect the group engagement team's involvement in the work of the component auditor include:

(a) The significance of the component;

(b) The identified significant risks of material misstatement of the group financial statements; and

(c) The group engagement team's understanding of the component auditor.

In the case of a significant component or identified significant risks, the group engagement team performs the procedures described in paragraphs 30-31. In the case of a component that is not a significant component, the nature, timing and extent of the group engagement team's involvement in the work of the component auditor will vary based on the group engagement team's understanding of that component auditor. The fact that the component is not a significant component becomes secondary. For example, even though a component is not considered a significant component, the group engagement team nevertheless may decide to be involved in the component auditor's risk assessment, because it has less than serious concerns about the component auditor's professional competency (for example, lack of industry specific knowledge), or the component auditor does not operate in an environment that actively oversees auditors.

A55. Forms of involvement in the work of a component auditor other than those described in paragraphs 30-31 and 42 may, based on the group engagement team's understanding of the component auditor, include one or more of the following:

(a) Meeting with component management or the component auditors to obtain an understanding of the component and its environment.

(b) Reviewing the component auditors' overall audit strategy and audit plan.

[22] HKSRE 2400, "Engagements to Review Financial Statements."

[23] HKSRE 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity."

(c) Performing risk assessment procedures to identify and assess the risks of material misstatement at the component level. These may be performed with the component auditors, or by the group engagement team.

(d) Designing and performing further audit procedures. These may be designed and performed with the component auditors, or by the group engagement team.

(e) Participating in the closing and other key meetings between the component auditors and component management.

(f) Reviewing other relevant parts of the component auditors' audit documentation.

Consolidation Process

Consolidation Adjustments and Reclassifications (Ref: Para. 34)

A56. The consolidation process may require adjustments to amounts reported in the group financial statements that do not pass through the usual transaction processing systems, and may not be subject to the same internal controls to which other financial information is subject. The group engagement team's evaluation of the appropriateness, completeness and accuracy of the adjustments may include:

- Evaluating whether significant adjustments appropriately reflect the events and transactions underlying them;

- Determining whether significant adjustments have been correctly calculated, processed and authorized by group management and, where applicable, by component management;

- Determining whether significant adjustments are properly supported and sufficiently documented; and

- Checking the reconciliation and elimination of intra-group transactions and unrealized profits, and intra-group account balances.

Communication with the Component Auditor [23a] (Ref: Para. 40-41)

A57. If effective two-way communication between the group engagement team and the component auditors does not exist, there is a risk that the group engagement team may not obtain sufficient appropriate audit evidence on which to base the group audit opinion. Clear and timely communication of the group engagement team's requirements forms the basis of effective two-way communication between the group engagement team and the component auditor.

A58. The group engagement team's requirements are often communicated in a letter of instruction. Appendix 5 contains guidance on required and additional matters that may be included in such a letter of instruction. The component auditor's communication with the group engagement team often takes the form of a memorandum or report of work performed. Communication between the group engagement team and the component auditor, however, may not necessarily be in writing. For example, the group engagement team may visit the component auditor to discuss identified significant risks or review relevant parts of the component auditor's audit documentation. Nevertheless, the documentation requirements of this and other HKSAs apply.

[23a] Additional local guidance is provided in Appendix 6.

A59. In cooperating with the group engagement team, the component auditor, for example, would provide the group engagement team with access to relevant audit documentation if not prohibited by law or regulation.

A60. Where a member of the group engagement team is also a component auditor, the objective for the group engagement team to communicate clearly with the component auditor can often be achieved by means other than specific written communication. For example:

- Access by the component auditor to the overall audit strategy and audit plan may be sufficient to communicate the group engagement team's requirements set out in paragraph 40; and
- A review of the component auditor's audit documentation by the group engagement team may be sufficient to communicate matters relevant to the group engagement team's conclusion set out in paragraph 41.

Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained

Reviewing the Component Auditor's Audit Documentation (Ref: Para. 42(b))

A61. What parts of the audit documentation of the component auditor will be relevant to the group audit may vary depending on the circumstances. Often the focus is on audit documentation that is relevant to the significant risks of material misstatement of the group financial statements. The extent of the review may be affected by the fact that the component auditor's audit documentation has been subjected to the component auditor's firm's review procedures.

Sufficiency and Appropriateness of Audit Evidence (Ref: Para. 44-45)

A62. If the group engagement team concludes that sufficient appropriate audit evidence on which to base the group audit opinion has not been obtained, the group engagement team may request the component auditor to perform additional procedures. If this is not feasible, the group engagement team may perform its own procedures on the financial information of the component.

A63. The group engagement partner's evaluation of the aggregate effect of any misstatements (either identified by the group engagement team or communicated by component auditors) allows the group engagement partner to determine whether the group financial statements as a whole are materially misstated.

Communication with Group Management and Those Charged with Governance of the Group

Communication with Group Management (Ref: Para. 46-48)

A64. HKSA 240 contains requirements and guidance on communication of fraud to management and, where management may be involved in the fraud, to those charged with governance.[24]

A65. Group management may need to keep certain material sensitive information confidential. Examples of matters that may be significant to the financial statements of the component of which component management may be unaware include the following:

- Potential litigation.
- Plans for abandonment of material operating assets.

[24] HKSA 240, paragraphs 40-42.

- Subsequent events.
- Significant legal agreements.

Communication with Those Charged with Governance of the Group (Ref: Para. 49)

A66. The matters the group engagement team communicates to those charged with governance of the group may include those brought to the attention of the group engagement team by component auditors that the group engagement team judges to be significant to the responsibilities of those charged with governance of the group. Communication with those charged with governance of the group takes place at various times during the group audit. For example, the matters referred to in paragraph 49(a)-(b) may be communicated after the group engagement team has determined the work to be performed on the financial information of the components. On the other hand, the matter referred to in paragraph 49(c) may be communicated at the end of the audit, and the matters referred to in paragraph 49(d)-(e) may be communicated when they occur.

Appendix 1

(Ref: Para. A19)

~~Example~~ Illustration of Auditor's Report ~~a Qualified Opinion~~ Where the Group Engagement Team Is Not Able to Obtain Sufficient Appropriate Audit Evidence on Which to Base the Group Audit Opinion

Illustration – Example of a Qualified Opinion Where the Group Engagement Team Is Not Able to Obtain Sufficient Appropriate Audit Evidence on Which to Base the Group Audit Opinion

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of consolidated financial statements of an entity other than a listed entity using Hong Kong Financial Reporting Standards (HKFRSs). The audit is a group audit (i.e. HKSA 600 applies).
- The consolidated financial statements are prepared by the directors of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of the directors' responsibility for the consolidated financial statements in HKSA 210.
- The group engagement team is unable to obtain sufficient appropriate audit evidence relating to a significant component accounted for by the equity method (recognized at $15 million in the statement of financial position, which reflects total assets of $60 million) because the group engagement team did not have access to the accounting records, management, or auditor of the component[1a].
- The group engagement team has read the audited financial statements of the component as at 31 December 20X1, including the auditor's report thereon, and considered related financial information kept by group management in relation to the component.
- In the group engagement partner's judgment, the effect on the group financial statements of this inability to obtain sufficient appropriate audit evidence is material but not pervasive.[1]
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with HKSA 701.
- The auditor has obtained all of the other information prior to the date of the auditor's report and the qualified opinion on the consolidated financial statements also affects the other information.

[1a] Additional local guidance is provided in Appendix 6.

[1] If, in the group engagement partner's judgment, the effect on the group financial statements of the inability to obtain sufficient appropriate audit evidence is material and pervasive, the group engagement partner would disclaim an opinion in accordance with HKSA 705 (Revised).

- Those responsible for oversight of the consolidated financial statements differ from those responsible for the preparation of the consolidated financial statements.
- In addition to the audit of the consolidated financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance.

~~In this example, the group engagement team is unable to obtain sufficient appropriate audit evidence relating to a significant component accounted for by the equity method (recognized at $15 million in the statement of financial position, which reflects total assets of $60 million) because the group engagement team did not have access to the accounting records, management, or auditor of the component[1a].~~

~~The group engagement team has read the audited financial statements of the component as at 31 December 20X1, including the auditor's report thereon, and considered related financial information kept by group management in relation to the component.~~

~~In the group engagement partner's judgment, the effect on the group financial statements of this inability to obtain sufficient appropriate audit evidence is material but not pervasive.~~

INDEPENDENT AUDITOR'S REPORT

~~TO THE MEMBERS OF ABC LIMITED~~To the Members of ABC Company

(incorporated in Hong Kong with limited liability)[1b]

Report on the Audit of the Consolidated Financial Statements[2]

Qualified Opinion

We have audited the consolidated financial statements of ABC ~~Limited~~ Company~~(the "Company")~~ and its subsidiaries ("the Group") set out on pages … to …, which comprise the consolidated statement of financial position as at 31 December 20X1, and [the consolidated statement of profit or loss and][~~1c~~2a] the consolidated statement of profit or loss and other comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies ~~and other explanatory information~~.

In our opinion, except for the possible effects of the matter described in the *Basis for Qualified Opinion* section of our report, the consolidated financial statements give a true and fair view of the financial position of the Group as at 31 December 20X1, and of their financial performance and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by

~~1a Additional local guidance is provided in Appendix 6.~~

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

2 Not used.

~~3 Not used.~~

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

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

the Hong Kong Institute of Certified Public Accountants ("HKICPA") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Qualified Opinion

ABC Company's investment in XYZ Company, a foreign associate acquired during the year and accounted for by the equity method, is carried at $15 million on the consolidated statement of financial position as at 31 December 20X1, and ABC's share of XYZ's net income of $1 million is included in the consolidated [statement of profit or loss][statement of profit or loss and other comprehensive income][2a] for the year then ended. We were unable to obtain sufficient appropriate audit evidence about the carrying amount of ABC's investment in XYZ Limited as at 31 December 20X1 and ABC's share of XYZ's net income for the year because we were denied access to the financial information, the directors, and the auditors of XYZ. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.

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

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 6 in Appendix 2 of HKSA 720 (Revised). The last paragraph of the other information section in Illustration 6 would be customized to describe the specific matter giving rise to the qualified opinion that also affects the other information.*]

Responsibilities of Directors~~'~~ and Those Charged with Corporate Governance for the Consolidated Financial Statements [3] ~~*Responsibility for the Consolidated Financial Statements*~~

[*Reporting in accordance with HKSA 700 (Revised)*[4] *– see Illustration 4 in HKSA 700 (Revised*).]

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

Auditor's Responsibilitiies~~y~~ for the Audit of the Consolidated Financial Statements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 4 in HKSA 700 (Revised*).]

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3 Throughout these illustrative auditor's reports, the~~Or other~~ terms directors and those charged with governance may need to be replaced by another term that is appropriate in the context of the legal framework in the particular jurisdiction.

4 HKSA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

~~5 Not used.~~

~~Our responsibility is to express an opinion on these consolidated financial statements based on our audit[3a]. We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.~~

~~An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation[6] of consolidated financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.[7] An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the consolidated financial statements.~~

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

~~*Basis for Qualified Opinion*~~

~~ABC Limited's investment in XYZ Limited, a foreign associate acquired during the year and accounted for by the equity method, is carried at $15 million on the consolidated statement of financial position as at 31 December 20X1, and ABC Limited's share of XYZ Limited's net income of $1 million is included in the consolidated [statement of profit or loss][statement of profit or loss and other comprehensive income][1c] for the year then ended. We were unable to obtain sufficient appropriate audit evidence about the carrying amount of ABC Limited's investment in XYZ Limited as at 31 December 20X1 and ABC Limited's share of XYZ Limited's net income for the year because we were denied access to the financial information, the directors, and the auditors of XYZ Limited. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.~~

~~*Qualified Opinion*~~

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

[3a] ~~Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".~~

[6] ~~Not used.~~

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

Report on ~~[Directors' Report under section 406(2) and]~~[8] Other Matters under sections 407(2)[5] and 407(3)~~[7]~~[5] of the Hong Kong Companies Ordinance[6]

~~[Directors' and Auditor's Respective Responsibility for the Directors' Report[6]~~

~~In addition to the respective responsibilities of the directors and auditor stated in above section "Report on the Consolidated Financial Statements", the directors of the Company are also responsible for the preparation of the directors' report as set out on pages … to … in accordance with the Hong Kong Companies Ordinance.~~

~~It is our responsibility to read the information in the directors' report for the year ended 31 December 20X1 as set out on pages … to … to identify and report inconsistencies with the consolidated financial statements. However, we have not audited or reviewed the directors' report and accordingly do not express an audit opinion or a review conclusion or any assurance conclusion on the directors' report as a whole.]~~

~~**Matters on which we are required to report by exception**~~

~~In accordance with the Hong Kong Companies Ordinance, we have the following matters to report. In our opinion:~~

- ~~[the information given in [*insert relevant paragraph/ section*] in the directors' report for the year ended 31 December 20X1 is not consistent with the consolidated financial statements for the year ended 31 December 20X1. [*State the details of the inconsistencies*[6].]]~~

~~i~~In respect alone of the inability to obtain sufficient appropriate audit evidence regarding an investment in a foreign associate as described in the *Basis for Qualified Opinion* ~~paragraph above~~section of our report:

- we were unable to determine whether adequate accounting records had been kept; and
- we have not obtained all the information and explanations that, to the best of our knowledge and belief, are necessary and material for the purpose of the audit.

~~8 Section 406(2) of the Hong Kong Companies Ordinance (CO) requires the auditor to opine on the directors' report:~~
~~(2) If a company's auditor is of the opinion that the information in a directors' report for a financial year is not consistent with the financial statements for the financial year, the auditor-~~
~~(a) must state that opinion in the auditor's report; and~~
~~(b) may bring that opinion to the members' attention at a general meeting.~~

5 Section 407 of the CO requires the auditor to opine on other matters:
(1) In preparing an auditor's report, the auditor must carry out an investigation that will enable the auditor to form an opinion as to—
(a) whether adequate accounting records have been kept by the company; and
(b) whether the financial statements are in agreement with the accounting records.
(2) A company's auditor must state the auditor's opinion in the auditor's report if the auditor is of the opinion that—
(a) adequate accounting records have not been kept by the company; or
(b) the financial statements are not in agreement with the accounting records in any material respect.
(3) If a company's auditor fails to obtain all the information or explanations that, to the best of the auditor's knowledge and belief, are necessary and material for the purpose of the audit, the auditor must state that fact in the auditor's report.
(4) If the financial statements do not comply with section 383(1), the auditor must include in the auditor's report, so far as the auditor is reasonably able to do so, a statement giving the particulars that are required to be, but have not been, contained in the financial statements.
Where the opinion on the financial statements has been modified, the auditor needs to evaluate what the consequences of this modification are on the reporting requirement under the CO, and further modify the report if necessary.

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

XYZ & Co.

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

[*Auditor's A~~a~~ddress*]

[*Date*]~~ of the auditor's report~~

~~If, in the group engagement partner's judgment, the effect on the group financial statements of the inability to obtain sufficient appropriate audit evidence is material and pervasive, the group engagement partner would disclaim an opinion in accordance with HKSA 705.~~

Appendix 2

(Ref: Para. A23)

Examples of Matters about Which the Group Engagement Team Obtains an Understanding

The examples provided cover a broad range of matters; however, not all matters are relevant to every group audit engagement and the list of examples is not necessarily complete.

Group-Wide Controls

1. Group-wide controls may include a combination of the following:

   - Regular meetings between group and component management to discuss business developments and to review performance.
   - Monitoring of components' operations and their financial results, including regular reporting routines, which enables group management to monitor components' performance against budgets, and to take appropriate action.
   - Group management's risk assessment process, that is, the process for identifying, analyzing and managing business risks, including the risk of fraud, that may result in material misstatement of the group financial statements.
   - Monitoring, controlling, reconciling, and eliminating intra-group transactions and unrealized profits, and intra-group account balances at group level.
   - A process for monitoring the timeliness and assessing the accuracy and completeness of financial information received from components.
   - A central IT system controlled by the same general IT controls for all or part of the group.
   - Control activities within an IT system that is common for all or some components.
   - Monitoring of controls, including activities of the internal audit function and self-assessment programs.
   - Consistent policies and procedures, including a group financial reporting procedures manual.
   - Group-wide programs, such as codes of conduct and fraud prevention programs.
   - Arrangements for assigning authority and responsibility to component management.

2. The internal audit function may be regarded as part of group-wide controls, for example, when the function is centralized. HKSA 610 (Revised 2013) [1] deals with the group engagement team's evaluation of whether the internal audit function's organizational status and relevant policies and procedures adequately supports the objectivity of internal auditors, the level of competence of the internal audit function, and whether the function applies a systematic and disciplined approach where the group engagement team expects to use the function's work.

[1] HKSA 610 (Revised 2013), "Using the Work of Internal Auditors," paragraph 15.

Consolidation Process

3. The group engagement team's understanding of the consolidation process may include matters such as the following:

Matters relating to the applicable financial reporting framework:

- The extent to which component management has an understanding of the applicable financial reporting framework.
- The process for identifying and accounting for components in accordance with the applicable financial reporting framework.
- The process for identifying reportable segments for segment reporting in accordance with the applicable financial reporting framework.
- The process for identifying related party relationships and related party transactions for reporting in accordance with the applicable financial reporting framework.
- The accounting policies applied to the group financial statements, changes from those of the previous financial year, and changes resulting from new or revised standards under the applicable financial reporting framework.
- The procedures for dealing with components with financial year-ends different from the group's year-end.

Matters relating to the consolidation process:

- Group management's process for obtaining an understanding of the accounting policies used by components, and, where applicable, ensuring that uniform accounting policies are used to prepare the financial information of the components for the group financial statements, and that differences in accounting policies are identified, and adjusted where required in terms of the applicable financial reporting framework. Uniform accounting policies are the specific principles, bases, conventions, rules, and practices adopted by the group, based on the applicable financial reporting framework, that the components use to report similar transactions consistently. These policies are ordinarily described in the financial reporting procedures manual and reporting package issued by group management.
- Group management's process for ensuring complete, accurate and timely financial reporting by the components for the consolidation.
- The process for translating the financial information of foreign components into the currency of the group financial statements.
- How IT is organized for the consolidation, including the manual and automated stages of the process, and the manual and programmed controls in place at various stages of the consolidation process.
- Group management's process for obtaining information on subsequent events.

Matters relating to consolidation adjustments:

- The process for recording consolidation adjustments, including the preparation, authorization and processing of related journal entries, and the experience of personnel responsible for the consolidation.

- The consolidation adjustments required by the applicable financial reporting framework.
- Business rationale for the events and transactions that gave rise to the consolidation adjustments.
- Frequency, nature and size of transactions between components.
- Procedures for monitoring, controlling, reconciling and eliminating intra-group transactions and unrealized profits, and intra-group account balances.
- Steps taken to arrive at the fair value of acquired assets and liabilities, procedures for amortizing goodwill (where applicable), and impairment testing of goodwill, in accordance with the applicable financial reporting framework.
- Arrangements with a majority owner or minority interests regarding losses incurred by a component (for example, an obligation of the minority interest to make good such losses).

Appendix 3

(Ref: Para. A30)

Examples of Conditions or Events that May Indicate Risks of Material Misstatement of the Group Financial Statements

The examples provided cover a broad range of conditions or events; however, not all conditions or events are relevant to every group audit engagement and the list of examples is not necessarily complete.

- A complex group structure, especially where there are frequent acquisitions, disposals or reorganizations.
- Poor corporate governance structures, including decision-making processes, that are not transparent.
- Non-existent or ineffective group-wide controls, including inadequate group management information on monitoring of components' operations and their results.
- Components operating in foreign jurisdictions that may be exposed to factors such as unusual government intervention in areas such as trade and fiscal policy, and restrictions on currency and dividend movements; and fluctuations in exchange rates.
- Business activities of components that involve high risk, such as long-term contracts or trading in innovative or complex financial instruments.
- Uncertainties regarding which components' financial information require incorporation in the group financial statements in accordance with the applicable financial reporting framework, for example whether any special-purpose entities or non-trading entities exist and require incorporation.
- Unusual related party relationships and transactions.
- Prior occurrences of intra-group account balances that did not balance or reconcile on consolidation.
- The existence of complex transactions that are accounted for in more than one component.
- Components' application of accounting policies that differ from those applied to the group financial statements.
- Components with different financial year-ends, which may be utilized to manipulate the timing of transactions.
- Prior occurrences of unauthorized or incomplete consolidation adjustments.
- Aggressive tax planning within the group, or large cash transactions with entities in tax havens.
- Frequent changes of auditors engaged to audit the financial statements of components.

Appendix 4

(Ref: Para. A35)

Examples of a Component Auditor's Confirmations

The following is not intended to be a standard letter. Confirmations may vary from one component auditor to another and from one period to the next.

Confirmations often are obtained before work on the financial information of the component commences.

[Component Auditor Letterhead]

[Date]

[To Group Engagement Partner]

This letter is provided in connection with your audit of the group financial statements of [name of parent] for the year ended [date] for the purpose of expressing an opinion on whether the group financial statements present fairly, in all material respects (*or give a true and fair view of*), the financial position of the group as at [date] and (of) its financial performance and cash flows for the year then ended in accordance with [indicate applicable financial reporting framework].

We acknowledge receipt of your instructions dated [date], requesting us to perform the specified work on the financial information of [name of component] for the year ended [date].

We confirm that:

1. We will be able to comply with the instructions. / We advise you that we will not be able to comply with the following instructions [specify instructions] for the following reasons [specify reasons].

2. The instructions are clear and we understand them. / We would appreciate it if you could clarify the following instructions [specify instructions].

3. We will cooperate with you and provide you with access to relevant audit documentation.

We acknowledge that:

1. The financial information of [name of component] will be included in the group financial statements of [name of parent].

2. You may consider it necessary to be involved in the work you have requested us to perform on the financial information of [name of component] for the year ended [date].

3. You intend to evaluate and, if considered appropriate, use our work for the audit of the group financial statements of [name of parent].

In connection with the work that we will perform on the financial information of [name of component], a [describe component, for example, wholly-owned subsidiary, subsidiary, joint venture, investee accounted for by the equity or cost methods of accounting] of [name of parent], we confirm the following:

1. We have an understanding of [indicate relevant ethical requirements] that is sufficient to fulfill our responsibilities in the audit of the group financial statements, and will comply therewith. In particular, and with respect to [name of parent] and the other components in the group, we are independent within the meaning of [indicate relevant ethical requirements] and comply with the applicable requirements of [refer to rules] promulgated by [name of regulatory agency].

2. We have an understanding of Hong Kong Standards on Auditing and [indicate other national standards applicable to the audit of the group financial statements] that is sufficient to fulfill our responsibilities in the audit of the group financial statements and will conduct our work on the financial information of [name of component] for the year ended [date] in accordance with those standards.

3. We possess the special skills (for example, industry specific knowledge) necessary to perform the work on the financial information of the particular component.

4. We have an understanding of [indicate applicable financial reporting framework or group financial reporting procedures manual] that is sufficient to fulfill our responsibilities in the audit of the group financial statements.

We will inform you of any changes in the above representations during the course of our work on the financial information of [name of component].

[Auditor's signature]

[Date]

[Auditor's address]

Appendix 5

(Ref: Para. A58)

Required and Additional Matters Included in the Group Engagement Team's Letter of Instruction

Matters required by this HKSA to be communicated to the component auditor are shown in italicized text.

Matters that are relevant to the planning of the work of the component auditor:

- *A request for the component auditor, knowing the context in which the group engagement team will use the work of the component auditor, to confirm that the component auditor will cooperate with the group engagement team*.
- The timetable for completing the audit.
- Dates of planned visits by group management and the group engagement team, and dates of planned meetings with component management and the component auditor.
- A list of key contacts.
- *The work to be performed by the component auditor, the use to be made of that work*, and arrangements for coordinating efforts at the initial stage of and during the audit, including the group engagement team's planned involvement in the work of the component auditor.
- *The ethical requirements that are relevant to the group audit and, in particular, the independence requirements, for example, where the group auditor is prohibited by law or regulation from using internal auditors to provide direct assistance, it is relevant for the group auditor to consider whether the prohibition also extends to component auditors and, if so, to address this in the communication to the component auditors.* [1]
- *In the case of an audit or review of the financial information of the component, component materiality (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures), and the threshold above which misstatements cannot be regarded as clearly trivial to the group financial statements.*
- *A list of related parties prepared by group management, and any other related parties that the group engagement team is aware of, and a request that the component auditor communicates on a timely basis to the group engagement team related parties not previously identified by group management or the group engagement team.*
- Work to be performed on intra-group transactions and unrealized profits and intra-group account balances.
- Guidance on other statutory reporting responsibilities, for example reporting on group management's assertion on the effectiveness of internal control.
- Where time lag between completion of the work on the financial information of the components and the group engagement team's conclusion on the group financial statements is likely, specific instructions for a subsequent events review.

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1 HKSA 610 (Revised 2013), "Using the Work of Internal Auditors," paragraph A31.

Matters that are relevant to the conduct of the work of the component auditor:

- The findings of the group engagement team's tests of control activities of a processing system that is common for all or some components, and tests of controls to be performed by the component auditor.

- *Identified significant risks of material misstatement of the group financial statements, due to fraud or error, that are relevant to the work of the component auditor, and a request that the component auditor communicates on a timely basis any other significant risks of material misstatement of the group financial statements, due to fraud or error, identified in the component and the component auditor's response to such risks.*

- The findings of the internal audit function, based on work performed on controls at or relevant to components.

- A request for timely communication of audit evidence obtained from performing work on the financial information of the components that contradicts the audit evidence on which the group engagement team originally based the risk assessment performed at group level.

- A request for a written representation on component management's compliance with the applicable financial reporting framework, or a statement that differences between the accounting policies applied to the financial information of the component and those applied to the group financial statements have been disclosed.

- Matters to be documented by the component auditor.

Other information

- A request that the following be reported to the group engagement team on a timely basis:

    - Significant accounting, financial reporting and auditing matters, including accounting estimates and related judgments.

    - Matters relating to the going concern status of the component.

    - Matters relating to litigation and claims.

    - Significant deficiencies in internal control that the component auditor has identified during the performance of the work on the financial information of the component, and information that indicates the existence of fraud.

- A request that the group engagement team be notified of any significant or unusual events as early as possible.

- *A request that the matters listed in paragraph 41 be communicated to the group engagement team when the work on the financial information of the component is completed.*

Appendix 6

(Ref: Para. 40)

Additional Local Guidance on Communication with the Component Auditor

1. The group auditor is fully responsible for the auditor's opinion on the consolidated financial statements. Section 412 of the Companies Ordinance empowers an auditor to require information and explanation for the performance of the duties as auditor from the following persons, including:

   (a) an officer of the company;

   (b) the subsidiary undertaking;

   (c) a person who—

      (i) is an officer or auditor of the subsidiary undertaking; or

      (ii) was an officer or auditor of the subsidiary undertaking at the time to which the information or explanation relates; and

   (d) a person who—

      (i) holds or is accountable for any of the subsidiary undertaking's accounting records; or

      (ii) held or was accountable for the subsidiary undertaking's accounting records at the time to which the information or explanation relates.

   If a subsidiary undertaking of a company is not a company incorporated in Hong Kong, an auditor of the company may require the company to obtain from any of the persons specified in (b) to (d) above any information or explanation that the auditor reasonably requires for the performance of the duties as auditor of the company. In accordance with paragraph 11 of this HKSA, the auditor's report on the consolidated financial statements shall not refer to the fact that the financial statements of some subsidiaries or associates have been audited by other auditors.

HKSA 700 (Revised)
Issued August 2015

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

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

HONG KONG STANDARD ON AUDITING 700 (REVISED) FORMING AN OPINION AND REPORTING ON FINANCIAL STATEMENTS

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

CONTENTS

Hong Kong Standard on Auditing (HKSA) 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, should be read in conjunction with HKSA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing*.

Introduction

Scope of this HKSA

1. This Hong Kong Standard on Auditing (HKSA) deals with the auditor's responsibility to form an opinion on the financial statements. It also deals with the form and content of the auditor's report issued as a result of an audit of financial statements.

2. HKSA 701[1] deals with the auditor's responsibility to communicate key audit matters in the auditor's report. HKSA 705[2] (Revised) and HKSA 706[3] (Revised) deal with how the form and content of the auditor's report are affected when the auditor expresses a modified opinion or includes an Emphasis of Matter paragraph or an Other Matter paragraph in the auditor's report. Other HKSAs also contain reporting requirements that are applicable when issuing an auditor's report.

3. This HKSA applies to an audit of a complete set of general purpose financial statements and is written in that context. HKSA 800[4] deals with special considerations when financial statements are prepared in accordance with a special purpose framework. HKSA 805[5] deals with special considerations relevant to an audit of a single financial statement or of a specific element, account or item of a financial statement. This HKSA also applies to audits for which HKSA 800 or HKSA 805 apply.

4. The requirements of this HKSA are aimed at addressing an appropriate balance between the need for consistency and comparability in auditor reporting globally and the need to increase the value of auditor reporting by making the information provided in the auditor's report more relevant to users. This HKSA promotes consistency in the auditor's report, but recognizes the need for flexibility to accommodate particular circumstances of individual jurisdictions. Consistency in the auditor's report, when the audit has been conducted in accordance with HKSAs, promotes credibility in the global marketplace by making more readily identifiable those audits that have been conducted in accordance with globally recognized standards. It also helps to promote the user's understanding and to identify unusual circumstances when they occur.

Effective Date

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

Objectives

6. The objectives of the auditor are:

   (a) To form an opinion on the financial statements based on an evaluation of the conclusions drawn from the audit evidence obtained; and

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

[2] HKSA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*

[3] HKSA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*

[4] HKSA 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*

[5] HKSA 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement*

(b) To express clearly that opinion through a written report.

Definitions

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

   (a) General purpose financial statements – Financial statements prepared in accordance with a general purpose framework.

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

   The term "fair presentation framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework and:

   (i) Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or

   (ii) Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances.

   The term "compliance framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework, but does not contain the acknowledgements in (i) or (ii) above.[6]

   (c) Unmodified opinion – The opinion expressed by the auditor when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.[7]

8. Reference to "financial statements" in this HKSA means "a complete set of general purpose financial statements, including the related notes." The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information. The requirements of the applicable financial reporting framework determine the form and content of the financial statements, and what constitutes a complete set of financial statements.

9. Reference to "Hong Kong Financial Reporting Standards" in this HKSA means the Hong Kong Financial Reporting Standards (HKFRSs) issued by the Hong Kong Institute of Certified Public Accountants (HKICPA).

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6 HKSA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing*, paragraph 13(a)

7 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.

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.[8,9]

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;[10]

    (b) The auditor's conclusion, in accordance with HKSA 450, whether uncorrected misstatements are material, individually or in aggregate;[11] 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 adequately disclose the significant accounting policies selected and applied;

    (b) The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;

    (c) The accounting estimates made by management are reasonable;

    (d) The information presented in the financial statements is relevant, reliable, comparable, and understandable;

    (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. A4)

    (f) The terminology used in the financial statements, including the title of each financial statement, is appropriate.

14. When the financial statements are prepared in accordance with a fair presentation framework, the evaluation required by paragraphs 12–13 shall also include whether the financial statements achieve fair presentation. The auditor's evaluation as to whether the financial statements achieve fair presentation shall include consideration of:

    (a) The overall presentation, structure and content of the financial statements; and

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8 HKSA 200, paragraph 11

9 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.

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

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

(b) Whether the financial statements, including the related notes, represent the underlying transactions and events in a manner that achieves fair presentation.

15. The auditor shall evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework. (Ref: Para. A5–A10)

Form of Opinion

16. The auditor shall express an unmodified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

17. If the auditor:

(a) concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or

(b) is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement,

the auditor shall modify the opinion in the auditor's report in accordance with HKSA 705 (Revised).

18. If financial statements prepared in accordance with the requirements of a fair presentation framework do not achieve fair presentation, the auditor shall discuss the matter with management and, depending on the requirements of the applicable financial reporting framework and how the matter is resolved, shall determine whether it is necessary to modify the opinion in the auditor's report in accordance with HKSA 705 (Revised). (Ref: Para. A11)

19. When the financial statements are prepared in accordance with a compliance framework, the auditor is not required to evaluate whether the financial statements achieve fair presentation. However, if in extremely rare circumstances the auditor concludes that such financial statements are misleading, the auditor shall discuss the matter with management and, depending on how it is resolved, shall determine whether, and how, to communicate it in the auditor's report. (Ref: Para. A12)

Auditor's Report

20. The auditor's report shall be in writing. (Ref: Para. A13–A14)

Auditor's Report for Audits Conducted in Accordance with Hong Kong Standards on Auditing

Title

21. The auditor's report shall have a title that clearly indicates that it is the report of an independent auditor. (Ref: Para. A15)

Addressee

22. The auditor's report shall be addressed, as appropriate, based on the circumstances of the engagement. (Ref: Para. A16)

Auditor's Opinion

23. The first section of the auditor's report shall include the auditor's opinion, and shall have the heading "Opinion."

24. The Opinion section of the auditor's report shall also:

    (a) Identify the entity whose financial statements have been audited;

    (b) State that the financial statements have been audited;

    (c) Identify the title of each statement comprising the financial statements;

    (d) Refer to the notes, including the summary of significant accounting policies; and

    (e) Specify the date of, or period covered by, each financial statement comprising the financial statements. (Ref: Para. A17–A18)

25. When expressing an unmodified opinion on financial statements prepared in accordance with a fair presentation framework, the auditor's opinion shall, unless otherwise required by law or regulation, use one of the following phrases, which are regarded as being equivalent:

    (a) In our opinion, the accompanying financial statements present fairly, in all material respects, […] in accordance with [the applicable financial reporting framework]; or

    (b) In our opinion, the accompanying financial statements give a true and fair view of […] in accordance with [the applicable financial reporting framework].[11a] (Ref: Para. A19–A26)

26. When expressing an unmodified opinion on financial statements prepared in accordance with a compliance framework, the auditor's opinion shall be that the accompanying financial statements are prepared, in all material respects, in accordance with [the applicable financial reporting framework]. (Ref: Para. A21–A26)

27. If the reference to the applicable financial reporting framework in the auditor's opinion is not to HKFRSs issued by the HKICPA, the auditor's opinion shall identify the jurisdiction of origin of the framework.

Basis for Opinion

28. The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion", that: (Ref: Para. A27)

    (a) States that the audit was conducted in accordance with Hong Kong Standards on Auditing; (Ref: Para. A28)

    (b) Refers to the section of the auditor's report that describes the auditor's responsibilities under the HKSAs;

    (c) Includes a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit, and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements. The statement shall identify the jurisdiction of origin of the relevant ethical requirements or refer to the HKICPA's *Code of Ethics for Professional Accountants* (the Code); and (Ref: Para. A29–A34)

    (d) States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

[11a] In Hong Kong, the Companies Ordinance, the Main Board Listing Rules and GEM Listing Rules adopt the phrase "true and fair view".

Going Concern

29. Where applicable, the auditor shall report in accordance with HKSA 570 (Revised).[12]

Key Audit Matters

30. For audits of complete sets of general purpose financial statements of listed entities, the auditor shall communicate key audit matters in the auditor's report in accordance with HKSA 701.

31. When the auditor is otherwise required by law or regulation or decides to communicate key audit matters in the auditor's report, the auditor shall do so in accordance with HKSA 701. (Ref: Para. A35–A38)

Other Information

32. Where applicable, the auditor shall report in accordance with HKSA 720 (Revised).

Responsibilities for the Financial Statements

33. The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements." The auditor's report shall use the term that is appropriate in the context of the legal framework in the particular jurisdiction and need not refer specifically to "management". In some jurisdictions, the appropriate reference may be to those charged with governance.[12a] (Ref: Para. A39)

34. This section of the auditor's report shall describe management's responsibility for: (Ref: Para. A40–A43)

    (a) Preparing the financial statements in accordance with the applicable financial reporting framework, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and

    (b) Assessing the entity's ability to continue as a going concern[13] and whether the use of the going concern basis of accounting is appropriate as well as disclosing, if applicable, matters relating to going concern. The explanation of management's responsibility for this assessment shall include a description of when the use of the going concern basis of accounting is appropriate. (Ref: Para. A43)

35. This section of the auditor's report shall also identify those responsible for the oversight of the financial reporting process, when those responsible for such oversight are different from those who fulfill the responsibilities described in paragraph 33 above. In this case, the heading of this section shall also refer to "Those Charged with Governance" or such term that is appropriate in the context of the legal framework in the particular jurisdiction. (Ref: Para. A44)

36. When the financial statements are prepared in accordance with a fair presentation framework, the description of responsibilities for the financial statements in the auditor's report shall refer to "the preparation and fair presentation of these financial statements" or "the preparation of financial statements that give a true and fair view," as appropriate in the circumstances.

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[12] HKSA 570 (Revised), *Going Concern*, paragraphs 21–23

[12a] In Hong Kong, under the Hong Kong Companies Ordinance, directors are responsible for the preparation of financial statements that give a true and fair view.

[13] HKSA 570 (Revised), paragraph 2

Auditor's Responsibilities for the Audit of the Financial Statements

37. The auditor's report shall include a section with the heading "Auditor's Responsibilities for the Audit of the Financial Statements."

38. This section of the auditor's report shall: (Ref: Para. A45)

    (a) State that the objectives of the auditor are to:

        (i) Obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error; and

        (ii) Issue an auditor's report that includes the auditor's opinion. (Ref: Para. A46)

    (b) State that reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSAs will always detect a material misstatement when it exists; and

    (c) State that misstatements can arise from fraud or error, and either:

        (i) Describe that they are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements; or [14]

        (ii) Provide a definition or description of materiality in accordance with the applicable financial reporting framework. (Ref: Para. A47)

39. The Auditor's Responsibilities for the Audit of the Financial Statements section of the auditor's report shall further: (Ref: Para. A45)

    (a) State that, as part of an audit in accordance with HKSAs, the auditor exercises professional judgment and maintains professional skepticism throughout the audit; and

    (b) Describe an audit by stating that the auditor's responsibilities are:

        (i) To identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error; to design and perform audit procedures responsive to those risks; and to obtain audit evidence that is sufficient and appropriate to provide a basis for the auditor's opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

        (ii) To obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. In circumstances when the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, the auditor shall omit the phrase that the auditor's consideration of internal control is not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

        (iii) To evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

[14] HKSA 320, *Materiality in Planning and Performing an Audit,* paragraph 2

(iv) To conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. If the auditor concludes that a material uncertainty exists, the auditor is required to draw attention in the auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify the opinion. The auditor's conclusions are based on the audit evidence obtained up to the date of the auditor's report. However, future events or conditions may cause an entity to cease to continue as a going concern.

(v) When the financial statements are prepared in accordance with a fair presentation framework, to evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

(c) When HKSA 600[15] applies, further describe the auditor's responsibilities in a group audit engagement by stating that:

(i) The auditor's responsibilities are to obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the group to express an opinion on the group financial statements;

(ii) The auditor is responsible for the direction, supervision and performance of the group audit; and

(iii) The auditor remains solely responsible for the auditor's opinion.

40. The Auditor's Responsibilities for the Audit of the Financial Statements section of the auditor's report also shall: (Ref: Para. A45)

(a) State that the auditor communicates with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that the auditor identifies during the audit;

(b) For audits of financial statements of listed entities, state that the auditor provides those charged with governance with a statement that the auditor has complied with relevant ethical requirements regarding independence and communicate with them all relationships and other matters that may reasonably be thought to bear on the auditor's independence, and where applicable, related safeguards; and

(c) For audits of financial statements of listed entities and any other entities for which key audit matters are communicated in accordance with HKSA 701, state that, from the matters communicated with those charged with governance, the auditor determines those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. The auditor describes these matters in the auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, the auditor determines that a matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication. (Ref: Para. A48)

15 HKSA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

Location of the description of the auditor's responsibilities for the audit of the financial statements

41. The description of the auditor's responsibilities for the audit of the financial statements required by paragraphs 39–40 shall be included: (Ref: Para. A49)

    (a) Within the body of the auditor's report;

    (b) Within an appendix to the auditor's report, in which case the auditor's report shall include a reference to the location of the appendix; or (Ref: Para. A49–A50)

    (c) By a specific reference within the auditor's report to the location of such a description on a website of an appropriate authority[15a], where law, regulation or HKSAs expressly permit the auditor to do so. (Ref: Para. A49, A51–A52)

42. When the auditor refers to a description of the auditor's responsibilities on a website of an appropriate authority, the auditor shall determine that such description addresses, and is not inconsistent with, the requirements in paragraphs 39–40 of this HKSA. (Ref: Para. A51)

Other Reporting Responsibilities

43. If the auditor addresses other reporting responsibilities[15b] in the auditor's report on the financial statements that are in addition to the auditor's responsibilities under the HKSAs, these other reporting responsibilities shall be addressed in a separate section in the auditor's report with a heading titled "Report on Other Legal and Regulatory Requirements" or otherwise as appropriate to the content of the section, unless these other reporting responsibilities address the same topics as those presented under the reporting responsibilities required by the HKSAs in which case the other reporting responsibilities may be presented in the same section as the related report elements required by the HKSAs. (Ref: Para. A53–A55)

44. If other reporting responsibilities are presented in the same section as the related report elements required by the HKSAs, the auditor's report shall clearly differentiate the other reporting responsibilities from the reporting that is required by the HKSAs. (Ref: Para. A55)

45. If the auditor's report contains a separate section that addresses other reporting responsibilities, the requirements of paragraphs 20–40 of this HKSA shall be included under a section with a heading "Report on the Audit of the Financial Statements." The "Report on Other Legal and Regulatory Requirements" shall follow the "Report on the Audit of the Financial Statements." (Ref: Para. A55)

Name of the Engagement Partner

46. The name of the engagement partner shall be included in the auditor's report for audits of complete sets of general purpose financial statements of listed entities unless, in rare circumstances, such disclosure is reasonably expected to lead to a significant personal security threat. In the rare circumstances that the auditor intends not to include the name of the engagement partner in the auditor's report, the auditor shall discuss this intention with those charged with governance to inform the auditor's assessment of the likelihood and severity of a significant personal security threat. (Ref: Para. A56–A58)

[15a] A description of auditor's responsibilities for the audit of the financial statements of an entity incorporated in Hong Kong can be found in the HKICPA's website at http://www.hkicpa.org.hk/en/standards-and-regulations/standards/auditing-assurance/auditre/

[15b] For the requirements under the Hong Kong Companies Ordinance, reference may be made to PN 600.1 *Reports by the Auditor under the Hong Kong Companies Ordinance (Cap. 622)*.

Signature of the Auditor

47. The auditor's report shall be signed. (Ref: Para. A59–A60)

Auditor's Address

48. The auditor's report shall name the location in the jurisdiction where the auditor practices.

Date of the Auditor's Report

49. The auditor's report shall be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements, including evidence that: (Ref: Para. A61–A64)

(a) All the statements that comprise the financial statements, including the related notes, have been prepared; and

(b) Those with the recognized authority have asserted that they have taken responsibility for those financial statements.

Auditor's Report Prescribed by Law or Regulation

50. If the auditor is required by law or regulation of a specific jurisdiction to use a specific layout, or wording of the auditor's report, the auditor's report shall refer to Hong Kong Standards on Auditing only if the auditor's report includes, at a minimum, each of the following elements: (Ref: Para. A65–A66)

(a) A title.

(b) An addressee, as required by the circumstances of the engagement.

(c) An Opinion section containing an expression of opinion on the financial statements and a reference to the applicable financial reporting framework used to prepare the financial statements (including identifying the jurisdiction of origin of the financial reporting framework that is not Hong Kong Financial Reporting Standards, see paragraph 26).

(d) An identification of the entity's financial statements that have been audited.

(e) A statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit, and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements. The statement shall identify the jurisdiction of origin of the relevant ethical requirements or refer to the Code.

(f) Where applicable, a section that addresses, and is not inconsistent with, the reporting requirements in paragraph 22 of HKSA 570 (Revised).

(g) Where applicable, a Basis for Qualified (or Adverse) Opinion section that addresses, and is not inconsistent with, the reporting requirements in paragraph 23 of HKSA 570 (Revised).

(h) Where applicable, a section that includes the information required by HKSA 701, or additional information about the audit that is prescribed by law or regulation and that addresses, and is not inconsistent with, the reporting requirements in that HKSA.[16] (Ref: Para. A66–A67)

[16] HKSA 701, paragraphs 11–16

(i) Where applicable, a section that addresses the reporting requirements in paragraph 24 of HKSA 720 (Revised).[17]

(j) A description of management's responsibilities for the preparation of the financial statements and an identification of those responsible for the oversight of the financial reporting process that addresses, and is not inconsistent with, the requirements in paragraphs 33–36.

(k) A reference to Hong Kong Standards on Auditing and the law or regulation, and a description of the auditor's responsibilities for an audit of the financial statements that addresses, and is not inconsistent with, the requirements in paragraphs 37–40. (Ref: Para. A49–A50)

(l) For audits of complete sets of general purpose financial statements of listed entities, the name of the engagement partner unless, in rare circumstances, such disclosure is reasonably expected to lead to a significant personal security threat.

(m) The auditor's signature.

(n) The auditor's address.

(o) The date of the auditor's report.

Auditor's Report for Audits Conducted in Accordance with Both Auditing Standards of a Specific Jurisdiction and Hong Kong Standards on Auditing

51. An auditor may be required to conduct an audit in accordance with the auditing standards of a specific jurisdiction (the "other auditing standards"), and has additionally complied with the HKSAs in the conduct of the audit. If this is the case, the auditor's report may refer to Hong Kong Standards on Auditing in addition to the other auditing standards, but the auditor shall do so only if: (Ref: Para. A71–A72)

    (a) There is no conflict between the requirements in the other auditing standards and those in HKSAs that would lead the auditor (i) to form a different opinion, or (ii) not to include an Emphasis of Matter paragraph or Other Matter paragraph that, in the particular circumstances, is required by HKSAs; and

    (b) The auditor's report includes, at a minimum, each of the elements set out in paragraphs 50(a)–(o) above when the auditor uses the layout or wording specified by the other auditing standards. However, reference to "law or regulation" in paragraph 50(k) shall be read as reference to the other auditing standards. The auditor's report shall thereby identify such other auditing standards.

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. A73–A79)

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.

[17] HKSA 720 (Revised), paragraph 24

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 August 2015 (date of issue), this HKSA conforms with International Standard on Auditing (ISA) 700 (Revised) *Forming an Opinion and Reporting on Financial Statements*. Compliance with the requirements of this HKSA ensures compliance with ISA 700 (Revised).

56. Additional local explanations are provided in footnotes 11a, 12a, 15a, 15b, 21a, 21b, 31a, 32a and 33a.

57. Additional local guidance is provided in the Appendix.

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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.[18] 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).
- Possible management bias in the making of accounting estimates.

A3. HKSA 540 addresses possible management bias in making accounting estimates.[19] Indicators of possible management bias do not constitute misstatements for purposes of drawing conclusions on the reasonableness of individual accounting estimates. They may, however, affect the auditor's evaluation of whether the financial statements as a whole are free from material misstatement.

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[18] HKSA 260 (Revised), *Communication with Those Charged with Governance*, Appendix 2

[19] HKSA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*, paragraph 21

Disclosures of the Effect of Material Transactions and Events on the Information Conveyed in the Financial Statements (Ref: Para. 13(e))

A4. It is common for financial statements prepared in accordance with a general purpose framework to present an entity's financial position, financial performance and cash flows. In such circumstances, the auditor evaluates whether the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the entity's financial position, financial performance and cash flows.

Description of the Applicable Financial Reporting Framework (Ref: Para. 15)

A5. As explained in HKSA 200, the preparation of the financial statements by management and, where appropriate, those charged with governance requires the inclusion of an adequate description of the applicable financial reporting framework in the financial statements.[20] That description advises users of the financial statements of the framework on which the financial statements are based.

A6. A description that the financial statements are prepared in accordance with a particular applicable financial reporting framework is appropriate only if the financial statements comply with all the requirements of that framework that are effective during the period covered by the financial statements.

A7. A description of the applicable financial reporting framework that contains imprecise qualifying or limiting language (e.g., "the financial statements are in substantial compliance with Hong Kong Financial Reporting Standards") is not an adequate description of that framework as it may mislead users of the financial statements.

Reference to More than One Financial Reporting Framework

A8. In some cases, the financial statements may represent that they are prepared in accordance with two financial reporting frameworks (e.g., HKFRSs and other financial reporting framework). This may be because management is required, or has chosen, to prepare the financial statements in accordance with both frameworks, in which case both are applicable financial reporting frameworks. Such description is appropriate only if the financial statements comply with each of the frameworks individually. To be regarded as being prepared in accordance with both frameworks, the financial statements need to comply with both frameworks simultaneously and without any need for reconciling statements. In practice, simultaneous compliance is unlikely unless the jurisdiction has eliminated all barriers to compliance with it.

A9. Financial statements that are prepared in accordance with one financial reporting framework and that contain a note or supplementary statement reconciling the results to those that would be shown under another framework are not prepared in accordance with that other framework. This is because the financial statements do not include all the information in the manner required by that other framework.

A10. The financial statements may, however, be prepared in accordance with one applicable financial reporting framework and, in addition, describe in the notes to the financial statements the extent to which the financial statements comply with another framework (e.g., financial statements prepared in accordance with other framework that also describe the extent to which they comply with HKFRSs). Such description may constitute supplementary financial

[20] HKSA 200, paragraphs A2–A3

information as discussed in paragraph 54 and is covered by the auditor's opinion if it cannot be clearly differentiated from the financial statements.

Form of Opinion (Ref: Para. 18–19)

A11. There may be cases where the financial statements, although prepared in accordance with the requirements of a fair presentation framework, do not achieve fair presentation. Where this is the case, it may be possible for management to include additional disclosures in the financial statements beyond those specifically required by the framework or, in extremely rare circumstances, to depart from a requirement in the framework in order to achieve fair presentation of the financial statements.

A12. It will be extremely rare for the auditor to consider financial statements that are prepared in accordance with a compliance framework to be misleading if, in accordance with HKSA 210, the auditor determined that the framework is acceptable.[21]

Auditor's Report (Ref: Para. 20)

A13. A written report encompasses reports issued in hard copy and those using an electronic medium.

A14. The Appendix to this HKSA contains illustrations of auditor's reports on financial statements, incorporating the elements set out in paragraphs 20–49. With the exception of the Opinion and Basis for Opinion sections, this HKSA does not establish requirements for ordering the elements of the auditor's report. However, this HKSA requires the use of specific headings, which are intended to assist in making auditor's reports that refer to audits that have been conducted in accordance with HKSAs more recognizable, particularly in situations where the elements of the auditor's report are presented in an order that differs from the illustrative auditor's reports in the Appendix to this HKSA.

Auditor's Report for Audits Conducted in Accordance with Hong Kong Standards on Auditing

Title (Ref: Para. 21)

A15. A title indicating the report is the report of an independent auditor, for example, "Independent Auditor's Report," distinguishes the independent auditor's report from reports issued by others.

Addressee (Ref: Para. 22)

A16. Law, regulation or the terms of the engagement may specify to whom the auditor's report is to be addressed in that particular jurisdiction. The auditor's report is normally addressed to those for whom the report is prepared, often either to the shareholders or to those charged with governance of the entity whose financial statements are being audited.[21a]

Auditor's Opinion (Ref. Para. 24–26)

Reference to the financial statements that have been audited

A17. The auditor's report states, for example, that the auditor has audited the financial statements of the entity, which comprise [state the title of each financial statement comprising the complete set of financial statements required by the applicable financial reporting framework, specifying

[21] HKSA 210, *Agreeing the Terms of Audit Engagements*, paragraph 6(a)

[21a] In Hong Kong, an auditor of a company incorporated under the Hong Kong Companies Ordinance has a statutory duty to prepare a report to the members of the company on the company's financial statements.

the date or period covered by each financial statement] and notes to the financial statements, including a summary of significant accounting policies.

A18. When the auditor is aware that the audited financial statements will be included in a document that contains other information, such as an annual report, the auditor may consider, if the form of presentation allows, identifying the page numbers on which the audited financial statements are presented. This helps users to identify the financial statements to which the auditor's report relates.

"Present fairly, in all material respects" or "give a true and fair view"

A19. The phrases "present fairly, in all material respects," and "give a true and fair view" are regarded as being equivalent. Whether the phrase "present fairly, in all material respects," or the phrase "give a true and fair view" is used in any particular jurisdiction is determined by the law or regulation governing the audit of financial statements in that jurisdiction, or by generally accepted practice in that jurisdiction. Where law or regulation requires the use of different wording, this does not affect the requirement in paragraph 14 of this HKSA for the auditor to evaluate the fair presentation of financial statements prepared in accordance with a fair presentation framework.

A20. When the auditor expresses an unmodified opinion, it is not appropriate to use phrases such as "with the foregoing explanation" or "subject to" in relation to the opinion, as these suggest a conditional opinion or a weakening or modification of opinion.

Description of the financial statements and the matters they present

A21. The auditor's opinion covers the complete set of financial statements as defined by the applicable financial reporting framework. For example, in the case of many general purpose frameworks, the financial statements may include: a statement of financial position, a statement of comprehensive income, a statement of changes in equity, a statement of cash flows, and related notes, which ordinarily comprise a summary of significant accounting policies and other explanatory information. In some jurisdictions, additional information may also be considered to be an integral part of the financial statements.

A22. In the case of financial statements prepared in accordance with a fair presentation framework, the auditor's opinion states that the financial statements present fairly, in all material respects, or give a true and fair view of, the matters that the financial statements are designed to present. For example, in the case of financial statements prepared in accordance with HKFRSs, these matters are *the financial position of the entity as at the end of the period and the entity's financial performance and cash flows for the period then ended*. Consequently, the […] in paragraph 25 and elsewhere in this HKSA is intended to be replaced by the words in italics in the preceding sentence when the applicable financial reporting framework is HKFRSs or, in the case of other applicable financial reporting frameworks, be replaced with words that describe the matters that the financial statements are designed to present.

Description of the applicable financial reporting framework and how it may affect the auditor's opinion

A23. The identification of the applicable financial reporting framework in the auditor's opinion is intended to advise users of the auditor's report of the context in which the auditor's opinion is expressed; it is not intended to limit the evaluation required in paragraph 14. The applicable financial reporting framework is identified in such terms as:

"… in accordance with Hong Kong Financial Reporting Standards" or

"… in accordance with accounting principles generally accepted in Jurisdiction X …"

A24. When the applicable financial reporting framework encompasses financial reporting standards and legal or regulatory requirements, the framework is identified in such terms as "… in accordance with Hong Kong Financial Reporting Standards and the requirements of Jurisdiction X Corporations Act."[21b] HKSA 210 deals with circumstances where there are conflicts between the financial reporting standards and the legislative or regulatory requirements.[22]

A25. As indicated in paragraph A8, the financial statements may be prepared in accordance with two financial reporting frameworks, which are therefore both applicable financial reporting frameworks. Accordingly, each framework is considered separately when forming the auditor's opinion on the financial statements, and the auditor's opinion in accordance with paragraphs 25–27 refers to both frameworks as follows:

(a) If the financial statements comply with each of the frameworks individually, two opinions are expressed: that is, that the financial statements are prepared in accordance with one of the applicable financial reporting frameworks (e.g., HKFRSs) and an opinion that the financial statements are prepared in accordance with the other applicable financial reporting framework (e.g., IFRSs). These opinions may be expressed separately or in a single sentence (e.g., the financial statements are presented fairly, in all material respects […], in accordance with HKFRSs and IFRSs).

(b) If the financial statements comply with one of the frameworks but fail to comply with the other framework, an unmodified opinion can be given that the financial statements are prepared in accordance with the one framework (e.g., HKFRSs) but a modified opinion given with regard to the other framework in accordance with HKSA 705 (Revised).

A26. As indicated in paragraph A10, the financial statements may represent compliance with the applicable financial reporting framework and, in addition, disclose the extent of compliance with another financial reporting framework. Such supplementary information is covered by the auditor's opinion if it cannot be clearly differentiated from the financial statements (see paragraphs 53–54 and related application material in paragraphs A73–A79). Accordingly,

(a) If the disclosure as to the compliance with the other framework is misleading, a modified opinion is expressed in accordance with HKSA 705 (Revised).

(b) If the disclosure is not misleading, but the auditor judges it to be of such importance that it is fundamental to the users' understanding of the financial statements, an Emphasis of Matter paragraph is added in accordance with HKSA 706 (Revised), drawing attention to the disclosure.

Basis for Opinion (Ref: Para. 28)

A27. The Basis for Opinion section provides important context about the auditor's opinion. Accordingly, this HKSA requires the Basis for Opinion section to directly follow the Opinion section in the auditor's report.

A28. The reference to the standards used conveys to the users of the auditor's report that the audit has been conducted in accordance with established standards.

Relevant ethical requirements

[21b] For companies incorporated in Hong Kong, the applicable Corporations Act is the Hong Kong Companies Ordinance.

[22] HKSA 210, paragraph 18

A29. The identification of the jurisdiction of origin of relevant ethical requirements increases transparency about those requirements relating to the particular audit engagement. HKSA 200 explains that relevant ethical requirements ordinarily comprise Parts A, B and D of the Code related to an audit of financial statements.[23] When the relevant ethical requirements include those of the Code, the statement may also make reference to the Code. If the Code constitutes all of the ethical requirements relevant to the audit, the statement need not identify a jurisdiction of origin.

A30. In some jurisdictions, relevant ethical requirements may exist in several different sources, such as the ethical code(s) and additional rules and requirements within law and regulation. When the independence and other relevant ethical requirements are contained in a limited number of sources, the auditor may choose to name the relevant source(s) (e.g., the name of the code, rule or regulation applicable in the jurisdiction), or may refer to a term that is commonly understood and that appropriately summarizes those sources (e.g., independence requirements for audits of private entities in Jurisdiction X).

A31. Law or regulation, or the terms of an audit engagement may require the auditor to provide in the auditor's report more specific information about the sources of the relevant ethical requirements, including those pertaining to independence, that applied to the audit of the financial statements.

A32. In determining the appropriate amount of information to include in the auditor's report when there are multiple sources of relevant ethical requirements relating to the audit of the financial statements, an important consideration is balancing transparency against the risk of obscuring other useful information in the auditor's report.

Considerations specific to group audits

A33. In group audits when there are multiple sources of relevant ethical requirements, including those pertaining to independence, the reference in the auditor's report to the jurisdiction ordinarily relates to the relevant ethical requirements that are applicable to the group engagement team. This is because, in a group audit, component auditors are also subject to ethical requirements that are relevant to the group audit.[24]

A34. The HKSAs do not establish specific independence or ethical requirements for auditors, including component auditors, and thus do not extend, or otherwise override, the independence requirements of the Code or other ethical requirements to which the group engagement team is subject, nor do the HKSAs require that the component auditor in all cases to be subject to the same specific independence requirements that are applicable to the group engagement team. As a result, relevant ethical requirements, including those pertaining to independence, in a group audit situation may be complex. HKSA 600[25] provides guidance for auditors in performing work on the financial information of a component for a group audit, including those situations where the component auditor does not meet the independence requirements that are relevant to the group audit.

Key Audit Matters (Ref: Para. 30)

A35. Law or regulation may require communication of key audit matters for audits of entities other than listed entities, for example, entities characterized in such law or regulation as public

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23 HKSA 200, paragraph A14

24 HKSA 600, paragraph A37

25 HKSA 600, paragraphs 19–20

interest entities.

A36. The auditor may also decide to communicate key audit matters for other entities, including those that may be of significant public interest, for example because they have a large number and wide range of stakeholders and considering the nature and size of the business. Examples of such entities may include financial institutions (such as banks, insurance companies, and pension funds), and other entities such as charities.

A37. HKSA 210 requires the auditor to agree the terms of the audit engagement with management and those charged with governance, as appropriate, and explains that the roles of management and those charged with governance in agreeing the terms of the audit engagement for the entity depend on the governance arrangements of the entity and relevant law or regulation.[26] HKSA 210 also requires the audit engagement letter or other suitable form of written agreement to include reference to the expected form and content of any reports to be issued by the auditor.[27] When the auditor is not otherwise required to communicate key audit matters, HKSA 210[28] explains that it may be helpful for the auditor to make reference in the terms of the audit engagement to the possibility of communicating key audit matters in the auditor's report and, in certain jurisdictions, it may be necessary for the auditor to include a reference to such possibility in order to retain the ability to do so.

Considerations specific to public sector entities

A38. Listed entities are not common in the public sector. However, public sector entities may be significant due to size, complexity or public interest aspects. In such cases, an auditor of a public sector entity may be required by law or regulation or may otherwise decide to communicate key audit matters in the auditor's report.

Responsibilities for the Financial Statements (Ref: Para. 33–34)

A39. HKSA 200 explains the premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit in accordance with HKSAs is conducted.[29] Management and, where appropriate, those charged with governance accept responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including, where relevant, their fair presentation. Management also accepts responsibility for such internal control as it determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. The description of management's responsibilities in the auditor's report includes reference to both responsibilities as it helps to explain to users the premise on which an audit is conducted. HKSA 260 (Revised) uses the term those charged with governance to describe the person(s) or organization(s) with responsibility for overseeing the entity, and provides a discussion about the diversity of governance structures across jurisdictions and by entity.

A40. There may be circumstances when it is appropriate for the auditor to add to the descriptions of the responsibilities of management and those charged with governance in paragraphs 34–35 to reflect additional responsibilities that are relevant to the preparation of the financial statements in the context of the particular jurisdiction or the nature of the entity.

[26] HKSA 210, paragraphs 9 and A21

[27] HKSA 210, paragraph 10

[28] HKSA 210, paragraph A23a

[29] HKSA 200, paragraph 13(j)

A41. HKSA 210 requires the auditor to agree management's responsibilities in an engagement letter or other suitable form of written agreement.[30] HKSA 210 provides some flexibility in doing so, by explaining that, if law or regulation prescribes the responsibilities of management and, where appropriate, those charged with governance in relation to financial reporting, the auditor may determine that the law or regulation includes responsibilities that, in the auditor's judgment, are equivalent in effect to those set out in HKSA 210. For such responsibilities that are equivalent, the auditor may use the wording of the law or regulation to describe them in the engagement letter or other suitable form of written agreement. In such cases, this wording may also be used in the auditor's report to describe the responsibilities as required by paragraph 34(a) of this HKSA. In other circumstances, including where the auditor decides not to use the wording of law or regulation as incorporated in the engagement letter, the wording in paragraph 34(a) of this HKSA is used. In addition to including the description of management's responsibilities in the auditor's report as required by paragraph 34, the auditor may refer to a more detailed description of these responsibilities by including a reference to where such information may be obtained (e.g., in the annual report of the entity or a website of an appropriate authority).

A42. In some jurisdictions, law or regulation prescribing management's responsibilities may specifically refer to a responsibility for the adequacy of accounting books and records, or accounting system. As books, records and systems are an integral part of internal control (as defined in HKSA 315 (Revised)[31]), the descriptions in HKSA 210 and in paragraph 34 do not make specific reference to them.

A43. The Appendix to this HKSA provides illustrations of how the requirement in paragraph 34(b) would be applied when HKFRSs is the applicable financial reporting framework. If an applicable financial reporting framework other than HKFRSs is used, the illustrative statements featured in the Appendix to this HKSA may need to be adapted to reflect the application of the other financial reporting framework in the circumstances.

Oversight of the financial reporting process (Ref: Para. 35)

A44. When some, but not all, of the individuals involved in the oversight of the financial reporting process are also involved in preparing the financial statements, the description as required by paragraph 34 of this HKSA may need to be modified to appropriately reflect the particular circumstances of the entity. When individuals responsible for the oversight of the financial reporting process are the same as those responsible for the preparation of the financial statements, no reference to oversight responsibilities is required.

Auditor's Responsibilities for the Audit of the Financial Statements (Ref: Para. 37–40)

A45. The description of the auditor's responsibilities as required by paragraphs 37–40 of this HKSA may be tailored to reflect the specific nature of the entity, for example, when the auditor's report addresses consolidated financial statements. Illustration 2 in the Appendix to this HKSA includes an example of how this may be done.

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[30] HKSA 210, paragraph 6(b)(i)–(ii)

[31] HKSA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, paragraph 4(c)

Objectives of the auditor (Ref: Para. 38(a))

A46. The auditor's report explains that the objectives of the auditor are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes the auditor's opinion. These are in contrast to management's responsibilities for the preparation for the financial statements.

Description of materiality (Ref: Para. 38(c))

A47. The Appendix to this HKSA provides illustrations of how the requirement in paragraph 38(c), to provide a description of materiality, would be applied when HKFRSs is the applicable financial reporting framework. If an applicable financial reporting framework other than HKFRSs is used, the illustrative statements presented in the Appendix to this HKSA may need to be adapted to reflect the application of the other financial reporting framework in the circumstances.

Auditor's responsibilities relating to HKSA 701 (Ref: Para. 40(c))

A48. The auditor may also consider it useful to provide additional information in the description of the auditor's responsibilities beyond what is required by paragraph 40(c). For example, the auditor may make reference to the requirement in paragraph 9 of HKSA 701 to determine the matters that required significant auditor attention in performing the audit, taking into account areas of higher assessed risk of material misstatement or significant risks identified in accordance with HKSA 315 (Revised); significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty; and the effects on the audit of significant events or transactions that occurred during the period.

Location of the description of the auditor's responsibilities for the audit of the financial statements (Ref: Para. 41, 50(k))

A49. Including the information required by paragraphs 39–40 of this HKSA in an appendix to the auditor's report or, when law, regulation or HKSAs expressly permit, referring to a website of an appropriate authority containing such information may be a useful way of streamlining the content of the auditor's report. However, because the description of the auditor's responsibilities contains information that is necessary to inform users' expectations of an audit conducted in accordance with HKSAs, a reference is required to be included in the auditor's report indicating where such information can be accessed.

Location in an appendix (Ref: Para. 41(b), 50(k))

A50. Paragraph 41 permits the auditor to include the statements required by paragraphs 39–40 describing the auditor's responsibilities for the audit of the financial statements in an appendix to the auditor's report, provided that appropriate reference is made within the body of the auditor's report to the location of the appendix. The following is an illustration of how such a reference to an appendix could be made in the auditor's report:

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is included in appendix X of this auditor's report. This description, which is located at [*indicate page number or other specific reference to the location of the description*], forms part of our auditor's report.

Reference to a website of an appropriate authority (Ref: Para. 41(c), 42)

A51. Paragraph 41 explains that the auditor may refer to a description of the auditor's responsibilities located on a website of an appropriate authority, only if expressly permitted by law, regulation or HKSAs. The information on the website that is incorporated in the auditor's report by way of a specific reference to the website location where such information can be found may describe the auditor's work, or the audit in accordance with HKSAs more broadly, but it cannot be inconsistent with the description required in paragraphs 39–40 of this HKSA. This means that the wording of the description of the auditor's responsibilities on the website may be more detailed, or may address other matters relating to an audit of financial statements, provided that such wording reflects and does not contradict the matters addressed in paragraphs 39–40.

A52. An appropriate authority could be a national auditing standard setter, regulator, or an audit oversight body.[31a] Such organizations are well-placed to ensure the accuracy, completeness and continued availability of the standardized information. It would not be appropriate for the auditor to maintain such a website. The following is an illustration of how such a reference to a website could be made in the auditor's report:

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located at [*Organization's*] website at: [*website address*]. This description forms part of our auditor's report.

Other Reporting Responsibilities (Ref: Para. 43–45)

A53. In some jurisdictions, the auditor may have additional responsibilities to report on other matters that are supplementary to the auditor's responsibilities under the HKSAs. For example, the auditor may be asked to report certain matters if they come to the auditor's attention during the course of the audit of the financial statements. Alternatively, the auditor may be asked to perform and report on additional specified procedures, or to express an opinion on specific matters, such as the adequacy of accounting books and records, internal control over financial reporting or other information. Auditing standards in the specific jurisdiction often provide

[31a] In Hong Kong, the Hong Kong Institute of Certified Public Accountants is the only statutory licensing body of accountants responsible for the professional training, development and regulation of the accountancy profession.

guidance on the auditor's responsibilities with respect to specific additional reporting responsibilities in that jurisdiction.

A54. In some cases, the relevant law or regulation may require or permit the auditor to report on these other responsibilities as part of their auditor's report on the financial statements. In other cases, the auditor may be required or permitted to report on them in a separate report.

A55. Paragraphs 43–45 of this HKSA permit combined presentation of other reporting responsibilities and the auditor's responsibilities under the HKSAs only when they address the same topics and the wording of the auditor's report clearly differentiates the other reporting responsibilities from those under the HKSAs. Such clear differentiation may make it necessary for the auditor's report to refer to the source of the other reporting responsibilities and to state that such responsibilities are beyond those required under the HKSAs. Otherwise, other reporting responsibilities are required to be addressed in a separate section in the auditor's report with a heading "Report on Other Legal and Regulatory Requirements," or otherwise as appropriate to the content of the section. In such cases, paragraph 45 requires the auditor to include reporting responsibilities under the HKSAs under a heading titled "Report on the Audit of the Financial Statements."

Name of the Engagement Partner (Ref: Para. 46)

A56. HKSQC 1[32] requires that the firm establish policies and procedures to provide reasonable assurance that engagements are performed in accordance with professional standards and applicable legal and regulatory requirements. Notwithstanding these HKSQC 1 requirements, naming the engagement partner in the auditor's report is intended to provide further transparency to the users of the auditor's report of a complete set of general purpose financial statements of a listed entity.

A57. Law, regulation or HKSAs may require that the auditor's report include the name of the engagement partner responsible for audits other than those of complete sets of general purpose financial statements of listed entities. The auditor may also be required by law, regulation or HKSAs, or may decide to include additional information beyond the engagement partner's name in the auditor's report to further identify the engagement partner, for example, the engagement partner's professional license number that is relevant to the jurisdiction where the auditor practices.

A58. In rare circumstances, the auditor may identify information or be subject to experiences that indicate the likelihood of a personal security threat that, if the identity of the engagement partner is made public, may result in physical harm to the engagement partner, other engagement team members or other closely related individuals. However, such a threat does not include, for example, threats of legal liability or legal, regulatory or professional sanctions. Discussions with those charged with governance about circumstances that may result in physical harm may provide additional information about the likelihood or severity of the significant personal security threat. Law, regulation or HKSAs may establish further requirements that are relevant to determining whether the disclosure of the name of the engagement partner may be omitted.

[32] HKSQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements,* paragraph 32

Signature of the Auditor (Ref: Para. 47)

A59. The auditor's signature is either in the name of the audit firm, the personal name of the auditor or both, as appropriate for the particular jurisdiction. In addition to the auditor's signature, in certain jurisdictions, the auditor may be required to declare in the auditor's report the auditor's professional accountancy designation or the fact that the auditor or firm, as appropriate, has been recognized by the appropriate licensing authority in that jurisdiction.[32a]

A60. In some cases, law or regulation may allow for the use of electronic signatures in the auditor's report.

Date of the Auditor's Report (Ref: Para. 49)

A61. The date of the auditor's report informs the user of the auditor's report that the auditor has considered the effect of events and transactions of which the auditor became aware and that occurred up to that date. The auditor's responsibility for events and transactions after the date of the auditor's report is addressed in HKSA 560.[33]

A62. Since the auditor's opinion is provided on the financial statements and the financial statements are the responsibility of management, the auditor is not in a position to conclude that sufficient appropriate audit evidence has been obtained until evidence is obtained that all the statements that comprise the financial statements, including the related notes, have been prepared and management has accepted responsibility for them.

A63. In some jurisdictions, law or regulation identifies the individuals or bodies (e.g., the directors) that are responsible for concluding that all the statements that comprise the financial statements, including the related notes, have been prepared, and specifies the necessary approval process. In such cases, evidence is obtained of that approval before dating the report on the financial statements. In other jurisdictions, however, the approval process is not prescribed in law or regulation. In such cases, the procedures the entity follows in preparing and finalizing its financial statements in view of its management and governance structures are considered in order to identify the individuals or body with the authority to conclude that all the statements that comprise the financial statements, including the related notes, have been prepared. In some cases, law or regulation identifies the point in the financial statement reporting process at which the audit is expected to be complete.

[32a] According to section 409 of the Hong Kong Companies Ordinance required that an auditor's report must be signed –
(a) If the auditor is a natural person, by the auditor; or

(b) If the auditor is a firm or body corporate, by a natural person authorized to sign the auditor's name on the auditor's behalf.

In Hong Kong, the auditor's report is normally signed in the name of the firm because the firm as a whole assumes responsibility for the audit. To assist identification, the report will normally state the name of the firm of the auditor and the location of the auditor's office.

For a corporate practice, the auditor's report is signed by a director of the practice, who must be a professional accountant holding a current practising certificate. The auditor's report states the name of the corporate practice and the location of its office and is signed in the name of the corporate practice. The auditor's report also identifies the director responsible for the performance of the audit engagement contemplated by such report, and states his/her full name as appearing in his/her practising certificate and the practising certificate number.

For certain purposes, a printed copy of the auditor's report may be required to state the name of the auditor and be signed by the auditor (for example, the Hong Kong Inland Revenue Department normally requires a manuscript signed copy of the auditor's report). For published financial statements (e.g. those of listed companies) the auditor may sign the report in a form from which a final printed version is produced. In both these circumstances, the auditor may sign copies for identification purposes in order to provide appropriately signed auditor's reports, however, no further active procedures need be undertaken after the initial auditor's report has been signed.

[33] HKSA 560, *Subsequent Events*, paragraphs 10–17

A64. In some jurisdictions, final approval of the financial statements by shareholders is required before the financial statements are issued publicly. In these jurisdictions, final approval by shareholders is not necessary for the auditor to conclude that sufficient appropriate audit evidence has been obtained. The date of approval of the financial statements for purposes of HKSAs is the earlier date on which those with the recognized authority determine that all the statements that comprise the financial statements, including the related notes, have been prepared and that those with the recognized authority have asserted that they have taken responsibility for them.[33a]

Auditor's Report Prescribed by Law or Regulation (Ref: Para. 50)

A65. HKSA 200 explains that the auditor may be required to comply with legal or regulatory requirements in addition to HKSAs.[34] When the differences between the legal or regulatory requirements and HKSAs relate only to the layout and wording of the auditor's report, the requirements in paragraph 50(a)–(o) set out the minimum elements to be included in the auditor's report to enable a reference to the Hong Kong Standards on Auditing. In those circumstances, the requirements in paragraphs 21–49 that are not included in paragraph 50(a)–(o) do not need to be applied including, for example, the required ordering of the Opinion and Basis for Opinion sections.

A66. Where specific requirements in a particular jurisdiction do not conflict with HKSAs, the layout and wording required by paragraphs 21–49 of this HKSA assist users of the auditor's report in more readily recognizing the auditor's report as a report of an audit conducted in accordance with HKSAs.

Information Required by HKSA 701 (Ref: Para. 50(h))

A67. Law or regulation may require the auditor to provide additional information about the audit that was performed, which may include information that is consistent with the objectives of HKSA 701, or may prescribe the nature and extent of communication about such matters.

A68. The HKSAs do not override law or regulation that governs an audit of financial statements. When HKSA 701 is applicable, reference can only be made to HKSAs in the auditor's report if, in applying the law or regulation, the section required by paragraph 50(h) of this HKSA is not inconsistent with the reporting requirements in HKSA 701. In such circumstances, the auditor may need to tailor certain aspects of the communication of key audit matters in the auditor's report required by HKSA 701, for example by:

- Modifying the heading "Key Audit Matters", if law or regulation prescribes a specific heading;
- Explaining why the information required by law or regulation is being provided in the auditor's report, for example by making a reference to the relevant law or regulation and describing how that information relates to the key audit matters;
- Where law or regulation prescribes the nature and extent of the description, supplementing the prescribed information to achieve an overall description of each key audit matter that is consistent with the requirement in paragraph 13 of HKSA 701.

[33a] In Hong Kong, the auditor would not date the auditor’s report earlier than the date on which the financial statements are approved by the directors. In practice, the date of the auditor’s report may be earlier than the date of physical signature of the auditor's report.

[34] HKSA 200, paragraph A55

A69. HKSA 210 deals with circumstances where law or regulation of the relevant jurisdiction prescribes the layout or wording of the auditor's report in terms that are significantly different from the requirements of HKSAs, which in particular includes the auditor's opinion. In these circumstances, HKSA 210 requires the auditor to evaluate:

(a) Whether users might misunderstand the assurance obtained from the audit of the financial statements and, if so,

(b) Whether additional explanation in the auditor's report can mitigate possible misunderstanding.

If the auditor concludes that additional explanation in the auditor's report cannot mitigate possible misunderstanding, HKSA 210 requires the auditor not to accept the audit engagement, unless required by law or regulation to do so. In accordance with HKSA 210, an audit conducted in accordance with such law or regulation does not comply with HKSAs. Accordingly, the auditor does not include any reference in the auditor's report to the audit having been conducted in accordance with Hong Kong Standards on Auditing.[35]

Considerations specific to public sector entities

A70. Auditors of public sector entities may also have the ability pursuant to law or regulation to report publicly on certain matters, either in the auditor's report or in a supplementary report, which may include information that is consistent with the objectives of HKSA 701. In such circumstances, the auditor may need to tailor certain aspects of the communication of key audit matters in the auditor's report required by HKSA 701 or include a reference in the auditor's report to a description of the matter in the supplementary report.

Auditor's Report for Audits Conducted in Accordance with Both Auditing Standards of a Specific Jurisdiction and Hong Kong Standards on Auditing (Ref: Para. 51)

A71. The auditor may refer in the auditor's report to the audit having been conducted in accordance with both Hong Kong Standards on Auditing as well as the other auditing standards when, in addition to complying with the relevant other auditing standards, the auditor complies with each of the HKSAs relevant to the audit.[36]

A72. A reference to both Hong Kong Standards on Auditing and the other auditing standards is not appropriate if there is a conflict between the requirements in HKSAs and those in the other auditing standards that would lead the auditor to form a different opinion or not to include an Emphasis of Matter or Other Matter paragraph that, in the particular circumstances, is required by HKSAs. In such a case, the auditor's report refers only to the auditing standards (either Hong Kong Standards on Auditing or the other auditing standards) in accordance with which the auditor's report has been prepared.

Supplementary Information Presented with the Financial Statements (Ref: Para. 53–54)

A73. In some circumstances, the entity may be required by law, regulation or standards, or may voluntarily choose, to present together with the financial statements supplementary information that is not required by the applicable financial reporting framework. For example, supplementary information might be presented to enhance a user's understanding of the applicable financial reporting framework or to provide further explanation of specific financial

[35] HKSA 210, paragraph 21

[36] HKSA 200, paragraph A56

statement items. Such information is normally presented in either supplementary schedules or as additional notes.

A74. Paragraph 53 of this HKSA explains that the auditor's opinion covers supplementary information that is an integral part of the financial statements because of its nature or how it is presented. This evaluation is a matter of professional judgment. To illustrate:

- When the notes to the financial statements include an explanation or the reconciliation of the extent to which the financial statements comply with another financial reporting framework, the auditor may consider this to be supplementary information that cannot be clearly differentiated from the financial statements. The auditor's opinion would also cover notes or supplementary schedules that are cross-referenced from the financial statements.

- When an additional profit and loss account that discloses specific items of expenditure is disclosed as a separate schedule included as an Appendix to the financial statements, the auditor may consider this to be supplementary information that can be clearly differentiated from the financial statements.

A75. Supplementary information that is covered by the auditor's opinion does not need to be specifically referred to in the auditor's report when the reference to the notes in the description of the statements that comprise the financial statements in the auditor's report is sufficient.

A76. Law or regulation may not require that the supplementary information be audited, and management may decide to ask the auditor not to include the supplementary information within the scope of the audit of the financial statements.

A77. The auditor's evaluation whether unaudited supplementary information is presented in a manner that could be construed as being covered by the auditor's opinion includes, for example, where that information is presented in relation to the financial statements and any audited supplementary information, and whether it is clearly labeled as "unaudited."

A78. Management could change the presentation of unaudited supplementary information that could be construed as being covered by the auditor's opinion, for example, by:

- Removing any cross-references from the financial statements to unaudited supplementary schedules or unaudited notes so that the demarcation between the audited and unaudited information is sufficiently clear.

- Placing the unaudited supplementary information outside of the financial statements or, if that is not possible in the circumstances, at a minimum placing the unaudited notes together at the end of the required notes to the financial statements and clearly labeling them as unaudited. Unaudited notes that are intermingled with the audited notes can be misinterpreted as being audited.

A79. The fact that supplementary information is unaudited does not relieve the auditor of the responsibilities described in HKSA 720 (Revised).

Appendix

(Ref: Para. A14)

Illustrations of Independent Auditor's Reports on Financial Statements

- Illustration 1: An auditor's report for a listed entity incorporated in Hong Kong and where the financial statements are prepared in accordance with Hong Kong Financial Reporting Standards
- Illustration 2: An auditor's report for a listed entity incorporated in Hong Kong submitting consolidated financial statements and where the consolidated financial statements are prepared in accordance with Hong Kong Financial Reporting Standards
- Illustration 3: An auditor's report for an entity other than a listed entity incorporated in Hong Kong and where the financial statements are prepared in accordance with Hong Kong Financial Reporting Standards
- Illustration 4: An auditor's report for an entity other than a listed entity incorporated in Hong Kong submitting consolidated financial statements and where the consolidated financial statements are prepared in accordance with Hong Kong Financial Reporting Standards
- Illustration 5: An auditor's report for an entity other than a listed entity incorporated in Hong Kong and where the financial statements are prepared in accordance with Hong Kong Small and Medium-Sized Entity Financial Reporting Standard
- Illustration 6: An auditor's report for a listed entity incorporated overseas and reporting in Hong Kong
- Illustration 7: An auditor's report for an entity other than a listed entity incorporated in Hong Kong and where the financial statements are prepared in accordance with Hong Kong Financial Reporting Standards for Private Entities
- Illustration 8: An auditor's report for an entity other than a listed entity incorporated in Hong Kong submitting consolidated financial statements and where the consolidated financial statements are prepared in accordance with Hong Kong Financial Reporting Standards for Private Entities

Illustration 1 – Auditor's Report for a Listed Entity Incorporated in Hong Kong and where the Financial Statements are Prepared in Accordance with Hong Kong Financial Reporting Standards

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of a listed entity using Hong Kong Financial Reporting Standards (HKFRSs). The audit is not a group audit (i.e., HKSA 600 does not apply).
- The financial statements are prepared by the directors of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of the directors' responsibility for the financial statements in HKSA 210.
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).
- Key audit matters have been communicated in accordance with HKSA 701.
- The auditor has obtained all of the other information prior to the date of the auditor's report and has not identified a material misstatement of the other information.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company

(incorporated in Hong Kong with limited liability)[1]

Report on the Audit of the Financial Statements[2]

Opinion

We have audited the financial statements of ABC Company ("the Company") set out on pages …… to ……, which comprise the statement of financial position as at 31 December 20X1, and [the statement of profit or loss and][3] the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

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

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

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

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") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") 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"), and we have fulfilled our other ethical responsibilities in accordance with 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 Statements[4]

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 Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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.

[4] Throughout these illustrative auditor's reports, the terms directors and those charged with governance may need to be replaced by another term that is appropriate in the context of the legal framework in the particular jurisdiction.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.[5] Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Paragraph 41(b) of this HKSA explains that the shaded material below can be located in an Appendix to the auditor's report. Paragraph 41(c) explains that when law, regulation or HKSAs expressly permit, reference can be made to a website of an appropriate authority that contains the description of the auditor's responsibilities, rather than including this material in the auditor's report, provided that the description on the website addresses, and is not inconsistent with, the description of the auditor's responsibilities below.

As part of an audit in accordance with HKSAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.[6]
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related

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

6 This sentence would be modified, as appropriate, in circumstances when the auditor also has a responsibility to issue an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements.

safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities prescribed by local law or regulation. The matters addressed by other law or regulation (referred to as "other reporting responsibilities") shall be addressed within this section unless the other reporting responsibilities address the same topics as those presented under the reporting responsibilities required by the HKSAs as part of the Report on the Audit of the Financial Statements section. The reporting of other reporting responsibilities that address the same topics as those required by the HKSAs may be combined (i.e., included in the Report on the Audit of the Financial Statements section under the appropriate subheadings) provided that the wording in the auditor's report clearly differentiates the other reporting responsibilities from the reporting that is required by the HKSAs where such a difference exists.*][7]

The engagement partner on the audit resulting in this independent auditor's report is [*name*].

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[*Auditor Address*]

[*Date*]

[7] For further guidance on non-compliance with the Hong Kong Companies Ordinance, refer to HKSA 705 (Revised) "Modifications to the Opinion in the Independent Auditor's Report", Appendix, Illustrations 3, 4 and 5.

Illustration 2 – Auditor's Report for a Listed Entity Incorporated in Hong Kong submitting Consolidated Financial Statements and where the Consolidated Financial Statements are Prepared in Accordance with Hong Kong Financial Reporting Standards

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of consolidated financial statements of a listed entity using Hong Kong Financial Reporting Standards (HKFRSs). The audit is a group audit of an entity with subsidiaries (i.e., HKSA 600 applies).
- The consolidated financial statements are prepared by the directors of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of the directors' responsibility for the consolidated financial statements in HKSA 210.
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).
- Key audit matters have been communicated in accordance with HKSA 701.
- The auditor has obtained all of the other information prior to the date of the auditor's report and has not identified a material misstatement of the other information.
- Those responsible for oversight of the consolidated financial statements differ from those responsible for the preparation of the consolidated financial statements.
- In addition to the audit of the consolidated financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company

(incorporated in Hong Kong with limited liability)[8]

Report on the Audit of the Consolidated Financial Statements[9]

Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries ("the Group") set out on pages …… to ……, which comprise the consolidated statement of financial position as at 31 December 20X1, and [the consolidated statement of profit or loss and][10] the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

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

[9] The sub-title “Report on the Audit of the Consolidated Financial Statements” is unnecessary in circumstances when the second sub-title “Report on Other Legal and Regulatory Requirements” is not applicable.

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

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 20X1, and of its consolidated financial performance and its consolidated 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") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") issued by the HKICPA. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Group in accordance with the HKICPA's *Code of Ethics for Professional Accountants* ("the Code"), and we have fulfilled our other ethical responsibilities in accordance with 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 consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated 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 Consolidated Financial Statements[11]

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

In preparing the consolidated financial statements, the directors are responsible for assessing the Group'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 Group or to cease operations, or have no realistic alternative but to do so.

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

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to

[11] Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction

issue an auditor's report that includes our opinion.[12] Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

Paragraph 41(b) of this HKSA explains that the shaded material below can be located in an Appendix to the auditor's report. Paragraph 41(c) explains that when law, regulation or HKSAs expressly permit, reference can be made to a website of an appropriate authority that contains the description of the auditor's responsibilities, rather than including this material in the auditor's report, provided that the description on the website addresses, and is not inconsistent with, the description of the auditor's responsibilities below.

As part of an audit in accordance with HKSAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.[13]
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related

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

[13] This sentence would be modified, as appropriate, in circumstances when the auditor also has a responsibility to issue an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements.

safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities prescribed by local law or regulation. The matters addressed by other law or regulation (referred to as "other reporting responsibilities") shall be addressed within this section unless the other reporting responsibilities address the same topics* as those *presented under the reporting responsibilities required by the HKSAs as part of the Report on the Audit of the Consolidated Financial Statements section. The reporting of other reporting responsibilities that address the same topics as those required by the HKSAs may be combined (i.e., included in the Report on the Audit of the Consolidated Financial Statements section under the appropriate subheadings) provided that the wording in the auditor's report clearly differentiates the other reporting responsibilities from the reporting that is required by the HKSAs where such a difference exists.*][14]

The engagement partner on the audit resulting in this independent auditor's report is [*name*].

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[*Auditor Address*]

[*Date*]

[14] For further guidance on non-compliance with the Hong Kong Companies Ordinance, refer to HKSA 705 (Revised) "Modifications to the Opinion in the Independent Auditor's Report", Appendix, Illustrations 3, 4 and 5.

Illustration 3 – Auditor's Report for an Entity Other than a Listed Entity Incorporated in Hong Kong and where the Financial Statements are Prepared in Accordance with Hong Kong Financial Reporting Standards

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of an entity other than a listed entity using Hong Kong Financial Reporting Standards (HKFRSs). The audit is not a group audit (i.e., HKSA 600 does not apply).
- The financial statements are prepared by the directors of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of the directors' responsibility for the financial statements in HKSA 210.
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with HKSA 701.
- The auditor has obtained all of the other information prior to the date of the auditor's report and has not identified a material misstatement of the other information.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company

(incorporated in Hong Kong with limited liability)[15]

Report on the Audit of the Financial Statements[16]

Opinion

We have audited the financial statements of ABC Company ("the Company") set out on pages …… to ……, which comprise the statement of financial position as at 31 December 20X1, and [the statement of profit or loss and][17] the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

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

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

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

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") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") 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"), and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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 Statements[18]

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 Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.[19] Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

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[18] Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction

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

Paragraph 41(b) of this HKSA explains that the shaded material below can be located in an Appendix to the auditor's report. Paragraph 41(c) explains that when law, regulation or HKSAs expressly permit, reference can be made to a website of an appropriate authority that contains the description of the auditor's responsibilities, rather than including this material in the auditor's report, provided that the description on the website addresses, and is not inconsistent with, the description of the auditor's responsibilities below.

As part of an audit in accordance with HKSAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.[20]
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities prescribed by local law or regulation. The matters addressed by other law or regulation (referred to as "other reporting responsibilities") shall be addressed within this section unless the other reporting responsibilities address the same topics as those presented under the reporting responsibilities required by the HKSAs as part of the Report on the Audit of the Financial Statements section. The reporting of other reporting responsibilities that address the same topics as those required by the HKSAs may be combined (i.e., included in the Report on the Audit of the Financial Statements section under the appropriate subheadings) provided that the wording in the auditor's report clearly differentiates the other reporting responsibilities from the reporting that is required by the HKSAs where such a difference exists.*][21]

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[20] This sentence would be modified, as appropriate, in circumstances when the auditor also has a responsibility to issue an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements.

[21] For further guidance on non-compliance with the Hong Kong Companies Ordinance, refer to HKSA 705 (Revised) "Modifications to the Opinion in the Independent Auditor’s Report", Appendix, Illustrations 3, 4 and 5.

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[*Auditor Address*]

[*Date*]

Illustration 4 – Auditor's Report for an Entity Other than a Listed Entity Incorporated in Hong Kong submitting Consolidated Financial Statements and where the Consolidated Financial Statements are Prepared in Accordance with Hong Kong Financial Reporting Standards

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of consolidated financial statements of an entity other than a listed entity using Hong Kong Financial Reporting Standards (HKFRSs). The audit is a group audit of an entity with subsidiaries (i.e., HKSA 600 applies).
- The consolidated financial statements are prepared by the directors of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of the directors' responsibility for the consolidated financial statements in HKSA 210.
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with HKSA 701.
- The auditor has obtained all of the other information prior to the date of the auditor's report and has not identified a material misstatement of the other information.
- Those responsible for oversight of the consolidated financial statements differ from those responsible for the preparation of the consolidated financial statements.
- In addition to the audit of the consolidated financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company

(incorporated in Hong Kong with limited liability)[22]

Report on the Audit of the Consolidated Financial Statements[23]

Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries ("the Group") set out on pages …… to ……, which comprise the consolidated statement of financial position as at 31 December 20X1, and [the consolidated statement of profit or loss and][24] the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

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

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

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

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Group as at 31 December 20X1, and of its consolidated financial performance and its consolidated 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") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Opinion

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

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 Consolidated Financial Statements[25]

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

In preparing the consolidated financial statements, the directors are responsible for assessing the Group'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 Group or to cease operations, or have no realistic alternative but to do so.

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

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.[26] Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

Paragraph 41(b) of this HKSA explains that the shaded material below can be located in an Appendix to the auditor's report. Paragraph 41(c) explains that when law, regulation or HKSAs expressly permit, reference can be made to a website of an appropriate authority that contains the description of the auditor's responsibilities, rather than including this material in the

25 Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction

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

auditor's report, provided that the description on the website addresses, and is not inconsistent with, the description of the auditor's responsibilities below.

As part of an audit in accordance with HKSAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.[27]
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities prescribed by local law or regulation. The matters addressed by other law or regulation (referred to as "other reporting responsibilities") shall be addressed within this section unless the other reporting responsibilities address the same topics* as those *presented under the reporting responsibilities required by the HKSAs as part of the Report on the Audit of the Consolidated Financial Statements section. The reporting of other reporting responsibilities that address the same topics as those required by the HKSAs may be combined (i.e., included in the Report on the Audit of the Consolidated Financial Statements section under the appropriate subheadings) provided that the wording*

[27] This sentence would be modified, as appropriate, in circumstances when the auditor also has a responsibility to issue an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements.

in the auditor's report clearly differentiates the other reporting responsibilities from the reporting that is required by the HKSAs where such a difference exists.][28]

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[*Auditor Address*]

[*Date*]

[28] For further guidance on non-compliance with the Hong Kong Companies Ordinance, refer to HKSA 705 (Revised) "Modifications to the Opinion in the Independent Auditor's Report", Appendix, Illustrations 3, 4 and 5.

Illustration 5 – Auditor's Report for an Entity Other than a Listed Entity Incorporated in Hong Kong and where the Financial Statements are Prepared in Accordance with Hong Kong Small and Medium-Sized Entity Financial Reporting Standard

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of an entity other than a listed entity using Hong Kong Small and Medium-Sized Entity Financial Reporting Standard (SME-FRS). The audit is not a group audit (i.e., HKSA 600 does not apply).
- The financial statements are prepared by the directors of the entity in accordance with the SME-FRS (that is, a financial reporting framework, encompassing law or regulation, designed to meet the common financial information needs of a wide range of users, but which is not a fair presentation framework).
- The terms of the audit engagement reflect the description of the directors' responsibility for the financial statements in HKSA 210.
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with HKSA 701.
- The auditor has obtained all of the other information prior to the date of the auditor's report and has not identified a material misstatement of the other information.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance.

INDEPENDENT AUDITOR'S REPORT

To the Members of SME Limited

(incorporated in Hong Kong with limited liability)[29]

Report on the Audit of the Financial Statements[30]

Opinion

We have audited the financial statements of SME Limited ("the Company") set out on pages …… to ……, which comprise the statement of financial position as at 31 December 20X1, and the income statement [and cash flow statement][31] for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

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

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

[31] An entity which prepares and presents its financial statements in accordance with the SME-FRS is not required to include a cash flow statement in those financial statements. However, an entity may voluntarily include a cash flow statement in those financial statements.

In our opinion, the financial statements of the Company are prepared, in all material respects, in accordance with the Hong Kong Small and Medium-Sized Entity Financial Reporting Standard ("SME-FRS") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") and with reference to PN 900 (Revised) *Audit of Financial Statements Prepared in Accordance with the Small and Medium-Sized Entity Financial Reporting Standard* 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"), and we have fulfilled our other responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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 Statements[32]

The directors are responsible for the preparation of the financial statements in accordance with the SME-FRS issued by the HKICPA and the Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.[33] Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Paragraph 41(b) of this HKSA explains that the shaded material below can be located in an Appendix to the auditor's report. Paragraph 41(c) explains that when law, regulation or HKSAs expressly permit, reference can be made to a website of an appropriate authority that contains the description of the auditor's responsibilities, rather than including this material in the

[32] Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction

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

auditor's report, provided that the description on the website addresses, and is not inconsistent with, the description of the auditor's responsibilities below.

As part of an audit in accordance with HKSAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.[34]
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities prescribed by local law or regulation. The matters addressed by other law or regulation (referred to as "other reporting responsibilities") shall be addressed within this section unless the other reporting responsibilities address the same topics as those presented under the reporting responsibilities required by the HKSAs as part of the Report on the Audit of the Financial Statements section. The reporting of other reporting responsibilities that address the same topics as those required by the HKSAs may be combined (i.e., included in the Report on the Audit of the Financial Statements section under the appropriate subheadings) provided that the wording in the auditor's report clearly differentiates the other reporting responsibilities from the reporting that is required by the HKSAs where such a difference exists.*][35]

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[*Auditor Address*]

[Date]

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[34] This sentence would be modified, as appropriate, in circumstances when the auditor also has responsibility to issue an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements.

[35] For further guidance on non-compliance with the Hong Kong Companies Ordinance, refer to HKSA 705 (Revised) "Modifications to the Opinion in the Independent Auditor’s Report", Appendix, Illustrations 3, 4 and 5.

Illustration 6 – Auditor's Report for a Listed Entity Incorporated Overseas and reporting in Hong Kong

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of a listed entity using Hong Kong Financial Reporting Standards (HKFRSs). The audit is not a group audit (i.e., HKSA 600 does not apply).
- The financial statements are prepared by the directors of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of the directors' responsibility for the financial statements in HKSA 210.
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit comprise the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants* together with the ethical requirements relating to the audit in the jurisdiction, and the auditor refers to both.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).
- Key audit matters have been communicated in accordance with HKSA 701.
- The auditor has obtained all of the other information prior to the date of the auditor's report and has not identified a material misstatement of the other information.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has reporting in Hong Kong.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company [or Other Appropriate Addressee]

(incorporated in [country or place] with limited liability)[36]

Report on the Audit of the Financial Statements[37]

Opinion

We have audited the financial statements of ABC Company ("the Company") set out on pages …… to ……, which comprise the statement of financial position as at 31 December 20X1, and [the statement of profit or loss and][38] the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

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

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

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

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 ("HKSAs") 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 Statements[41]

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 andusing 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.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.[42] Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Paragraph 41(b) of this HKSA explains that the shaded material below can be located in an Appendix to the auditor's report. Paragraph 41(c) explains that when law, regulation or HKSAs expressly permit, reference can be made to a website of an appropriate authority that contains the description of the auditor's responsibilities, rather than including this material in the auditor's report, provided that the description on the website addresses, and is not inconsistent with, the description of the auditor's responsibilities below.

As part of an audit in accordance with HKSAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.[43]
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related

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

[43] This sentence would be modified, as appropriate, in circumstances when the auditor also has a responsibility to issue an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements.

safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities prescribed by local law or regulation. The matters addressed by other law or regulation (referred to as "other reporting responsibilities") shall be addressed within this section unless the other reporting responsibilities address the same topics as those presented under the reporting responsibilities required by the HKSAs as part of the Report on the Audit of the Financial Statements section. The reporting of other reporting responsibilities that address the same topics as those required by the HKSAs may be combined (i.e., included in the Report on the Audit of the Financial Statements section under the appropriate subheadings) provided that the wording in the auditor's report clearly differentiates the other reporting responsibilities from the reporting that is required by the HKSAs where such a difference exists.*]

The engagement partner on the audit resulting in this independent auditor's report is [*name*].

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[*Auditor Address*]

[*Date*]

Illustration 7 – Auditor's Report for an Entity Other than a Listed Entity Incorporated in Hong Kong and where the Financial Statements are Prepared in Accordance with Hong Kong Financial Reporting Standards for Private Entities

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of an entity other than a listed entity using the Hong Kong Financial Reporting Standards for Private Entities (HKFRS for Private Entities). The audit is not a group audit (i.e., HKSA 600 does not apply).
- The financial statements are prepared by the directors of the entity in accordance with the HKFRS for Private Entities (a general purpose framework).
- The terms of the audit engagement reflect the description of the directors' responsibility for the financial statements in HKSA 210.
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with HKSA 701.
- The auditor has obtained all of the other information prior to the date of the auditor's report and has not identified a material misstatement of the other information.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company

(incorporated in Hong Kong with limited liability)[44]

Report on the Audit of the Financial Statements[45]

Opinion

We have audited the financial statements of ABC Company ("the Company") set out on pages …… to ……, which comprise the statement of financial position as at 31 December 20X1, and the [[income statement][statement of comprehensive income][46], statement of changes in equity][statement of income and retained earnings][47] and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

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

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

46 Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

47 According to paragraph 3.18 of the HKFRS for Private Entities, the entity may present a single statement of income and retained earnings in place of the statement of comprehensive income and statement of changes in equity.

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 for Private Entities ("HKFRS for Private Entities") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") 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"), and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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 Statements[48]

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

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.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.[49] Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with HKSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

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[48] Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction

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

Paragraph 41(b) of this HKSA explains that the shaded material below can be located in an Appendix to the auditor's report. Paragraph 41(c) explains that when law, regulation or HKSAs expressly permit, reference can be made to a website of an appropriate authority that contains the description of the auditor's responsibilities, rather than including this material in the auditor's report, provided that the description on the website addresses, and is not inconsistent with, the description of the auditor's responsibilities below.

As part of an audit in accordance with HKSAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.[50]
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities prescribed by local law or regulation. The matters addressed by other law or regulation (referred to as "other reporting responsibilities") shall be addressed within this section unless the other reporting responsibilities address the same topics as those presented under the reporting responsibilities required by the HKSAs as part of the Report on the Audit of the Financial Statements section. The reporting of other reporting responsibilities that address the same topics as those required by the HKSAs may be combined (i.e., included in the Report on the Audit of the Financial Statements section under the appropriate subheadings) provided that the wording in the auditor's report clearly differentiates the other reporting responsibilities from the reporting that is required by the HKSAs where such a difference exists.*][51]

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[50] This sentence would be modified, as appropriate, in circumstances when the auditor also has a responsibility to issue an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements.

[51] For further guidance on non-compliance with the Hong Kong Companies Ordinance, refer to HKSA 705 (Revised) "Modifications to the Opinion in the Independent Auditor’s Report", Appendix, Illustrations 3, 4 and 5.

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[*Auditor Address*]

[*Date*]

Illustration 8 – Auditor's Report for an Entity Other than a Listed Entity Incorporated in Hong Kong submitting Consolidated Financial Statements and where the Consolidated Financial Statements are Prepared in Accordance with Hong Kong Financial Reporting Standards for Private Entities

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of consolidated financial statements of an entity other than a listed entity using Hong Kong Financial Reporting Standards for Private Entities (HKFRS for Private Entities). The audit is a group audit of an entity with subsidiaries (i.e., HKSA 600 applies).
- The consolidated financial statements are prepared by the directors of the entity in accordance with HKFRS for Private Entities (a general purpose framework).
- The terms of the audit engagement reflect the description of the directors' responsibility for the consolidated financial statements in HKSA 210.
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with HKSA 701.
- The auditor has obtained all of the other information prior to the date of the auditor's report and has not identified a material misstatement of the other information.
- Those responsible for oversight of the consolidated financial statements differ from those responsible for the preparation of the consolidated financial statements.
- In addition to the audit of the consolidated financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company

(incorporated in Hong Kong with limited liability)[52]

Report on the Audit of the Consolidated Financial Statements[53]

Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries ("the Group") set out on pages …… to ……, which comprise the consolidated statement of financial position as at 31 December 20X1, and the consolidated [[income statement][statement of comprehensive income][54],

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

[53] The sub-title "Report on the Audit of the Consolidated Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

[54] Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

consolidated statement of changes in equity][statement of income and retained earnings] [55] and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

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

Basis for Opinion

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

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 Consolidated Financial Statements[56]

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

In preparing the consolidated financial statements, the directors are responsible for assessing the Group'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 Group or to cease operations, or have no realistic alternative but to do so.

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

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. [57] Reasonable assurance is a high level of

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[55] According to paragraph 3.18 of the HKFRS for Private Entities, the entity may present a single statement of income and retained earnings in place of the statement of comprehensive income and statement of changes in equity.

[56] Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction

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

assurance, but is not a guarantee that an audit conducted in accordance with HKSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

Paragraph 41(b) of this HKSA explains that the shaded material below can be located in an Appendix to the auditor's report. Paragraph 41(c) explains that when law, regulation or HKSAs expressly permit, reference can be made to a website of an appropriate authority that contains the description of the auditor's responsibilities, rather than including this material in the auditor's report, provided that the description on the website addresses, and is not inconsistent with, the description of the auditor's responsibilities below.

As part of an audit in accordance with HKSAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.[58]
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities prescribed by local law or regulation. The matters addressed by other law or regulation (referred to as "other reporting responsibilities") shall be addressed within this*

[58] This sentence would be modified, as appropriate, in circumstances when the auditor also has a responsibility to issue an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements.

section unless the other reporting responsibilities address the same topics as those *presented under the reporting responsibilities required by the HKSAs as part of the Report on the Audit of the Consolidated Financial Statements section. The reporting of other reporting responsibilities that address the same topics as those required by the HKSAs may be combined (i.e., included in the Report on the Audit of the Consolidated Financial Statements section under the appropriate subheadings) provided that the wording in the auditor's report clearly differentiates the other reporting responsibilities from the reporting that is required by the HKSAs where such a difference exists.]*[59]

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[*Auditor Address*]

[*Date*]

59 For further guidance on non-compliance with the Hong Kong Companies Ordinance, refer to HKSA 705 (Revised) "Modifications to the Opinion in the Independent Auditor's Report", Appendix, Illustrations 3, 4 and 5.

HKSA 701

Issued August 2015

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

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

HONG KONG STANDARD ON AUDITING 701 COMMUNICATING KEY AUDIT MATTERS IN THE INDEPENDENT AUDITOR'S REPORT

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

CONTENTS

Hong Kong Standard on Auditing (HKSA) 701, *Communicating Key Audit Matters in the Independent Auditor's Report,* should be read in conjunction with HKSA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing*.

Introduction

Scope of this HKSA

1. This Hong Kong Standard on Auditing (HKSA) deals with the auditor's responsibility to communicate key audit matters in the auditor's report. It is intended to address both the auditor's judgment as to what to communicate in the auditor's report and the form and content of such communication.

2. The purpose of communicating key audit matters is to enhance the communicative value of the auditor's report by providing greater transparency about the audit that was performed. Communicating key audit matters provides additional information to intended users of the financial statements ("intended users") to assist them in understanding those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Communicating key audit matters may also assist intended users in understanding the entity and areas of significant management judgment in the audited financial statements. (Ref: Para. A1–A4)

3. The communication of key audit matters in the auditor's report may also provide intended users a basis to further engage with management and those charged with governance about certain matters relating to the entity, the audited financial statements, or the audit that was performed.

4. Communicating key audit matters in the auditor's report is in the context of the auditor having formed an opinion on the financial statements as a whole. Communicating key audit matters in the auditor's report is not:

   (a) A substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation;

   (b) A substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with HKSA 705 (Revised);[1]

   (c) A substitute for reporting in accordance with HKSA 570 (Revised)[2] when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern; or

   (d) A separate opinion on individual matters. (Ref: Para. A5–A8)

5. This HKSA applies to audits of complete sets of general purpose financial statements of listed entities and circumstances when the auditor otherwise decides to communicate key audit matters in the auditor's report. This HKSA also applies when the auditor is required by law or regulation to communicate key audit matters in the auditor's report.[3] However, HKSA 705 (Revised) prohibits the auditor from communicating key audit matters when the auditor disclaims an opinion on the financial statements, unless such reporting is required by law or regulation.[4]

Effective Date

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

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[1] HKSA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*

[2] HKSA 570 (Revised), *Going Concern*, paragraphs 22–23

[3] HKSA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, paragraphs 30–31

[4] HKSA 705 (Revised), paragraph 29

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 have been identified as having high 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)

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

Key Audit Matters Not a Substitute for Expressing a Modified Opinion

12. The auditor shall not communicate a matter in the Key Audit Matters section of the auditor's report when the auditor would be required to modify the opinion in accordance with HKSA 705 (Revised) as a result of the matter. (Ref: Para. A5)

Descriptions of Individual Key Audit Matters

13. The description of each key audit matter in the Key Audit Matters section of the auditor's report shall include a reference to the related disclosure(s), if any, in the financial statements and shall address: (Ref: Para. A34–A41)

    (a) Why the matter was considered to be one of most significance in the audit and therefore determined to be a key audit matter; and (Ref: Para. A42–A45)

    (b) How the matter was addressed in the audit. (Ref: Para. A46–A51)

Circumstances in Which a Matter Determined to Be a Key Audit Matter Is Not Communicated in the Auditor's Report

14. The auditor shall describe each key audit matter in the auditor's report unless: (Ref: Para. A53–A56)

    (a) Law or regulation precludes public disclosure about the matter; or (Ref: Para. A52)

    (b) In extremely rare circumstances, the auditor determines that the matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication. This shall not apply if the entity has publicly disclosed information about the matter.

Interaction between Descriptions of Key Audit Matters and Other Elements Required to Be Included in the Auditor's Report

15. A matter giving rise to a modified opinion in accordance with HKSA 705 (Revised), or a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised), are by their nature key audit matters. However, in such circumstances, these matters shall not be described in the Key Audit Matters section of the auditor's report and the requirements in paragraphs 13–14 do not apply. Rather, the auditor shall:

    (a) Report on these matter(s) in accordance with the applicable HKSA(s); and

    (b) Include a reference to the Basis for Qualified (Adverse) Opinion or the Material Uncertainty Related to Going Concern section(s) in the Key Audit Matters section. (Ref: Para. A6–A7)

Form and Content of the Key Audit Matters Section in Other Circumstances

16. If the auditor determines, depending on the facts and circumstances of the entity and the audit, that there are no key audit matters to communicate or that the only key audit matters communicated are those matters addressed by paragraph 15, the auditor shall include a statement to this effect in a separate section of the auditor's report under the heading "Key Audit Matters." (Ref: Para. A57–A59)

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 August 2015 (date of issue), 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.

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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*

and may increase attention by management and those charged with governance to the disclosures in the financial statements to which reference is made in the auditor's report.

A4. HKSA 320[8] explains that it is reasonable for the auditor to assume that users of the financial statements:

(a) Have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence;

(b) Understand that the financial statements are prepared, presented and audited to levels of materiality;

(c) Recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment and the consideration of future events; and

(d) Make reasonable economic decisions on the basis of the information in the financial statements.

Because the auditor's report accompanies the audited financial statements, the users of the auditor's report are considered to be the same as the intended users of the financial statements.

Relationship between Key Audit Matters, the Auditor's Opinion and Other Elements of the Auditor's Report (Ref: Para. 4, 12, 15)

A5. HKSA 700 (Revised) establishes requirements and provides guidance on forming an opinion on the financial statements.[9] Communicating key audit matters is not a substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation. HKSA 705 (Revised) addresses circumstances in which the auditor concludes that there is a material misstatement relating to the appropriateness or adequacy of disclosures in the financial statements.[10]

A6. When the auditor expresses a qualified or adverse opinion in accordance with HKSA 705 (Revised), presenting the description of a matter giving rise to a modified opinion in the Basis for Qualified (Adverse) Opinion section helps to promote intended users' understanding and to identify such circumstances when they occur. Separating the communication of this matter from other key audit matters described in the Key Audit Matters section therefore gives it the appropriate prominence in the auditor's report (see paragraph 15). The Appendix in HKSA 705 (Revised) includes illustrative examples of how the introductory language in the Key Audit Matters section is affected when the auditor expresses a qualified or adverse opinion and other key audit matters are communicated in the auditor's report. Paragraph A58 of this HKSA illustrates how the Key Audit Matters section is presented when the auditor has determined that there are no other key audit matters to be communicated in the auditor's report beyond matters addressed in the Basis for Qualified (Adverse) Opinion section or Material Uncertainty Related to Going Concern section of the auditor's report.

[8] HKSA 320, *Materiality in Planning and Performing the Audit*, paragraph 4

[9] HKSA 700 (Revised), paragraphs 10–15 and A1–A10

[10] See paragraph A7 of HKSA 705 (Revised).

A7. When the auditor expresses a qualified or adverse opinion, communicating other key audit matters would still be relevant to enhancing intended users' understanding of the audit, and therefore the requirements to determine key audit matters apply. However, as an adverse opinion is expressed in circumstances when the auditor has concluded that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements:[11]

- Depending on the significance of the matter(s) giving rise to an adverse opinion, the auditor may determine that no other matters are key audit matters. In such circumstances, the requirement in paragraph 15 applies (see paragraph A58).
- If one or more matters other than the matter(s) giving rise to an adverse opinion are determined to be key audit matters, it is particularly important that the descriptions of such other key audit matters do not imply that the financial statements as a whole are more credible in relation to those matters than would be appropriate in the circumstances, in view of the adverse opinion (see paragraph A47).

A8. HKSA 706 (Revised)[12] establishes mechanisms for auditors of financial statements of all entities to include additional communication in the auditor's report through the use of Emphasis of Matter paragraphs and Other Matter paragraphs when the auditor considers it necessary to do so. In such cases, these paragraphs are presented separately from the Key Audit Matters section in the auditor's report. When a matter has been determined to be a key audit matter, the use of such paragraphs is not a substitute for the description of the individual key audit matter in accordance with paragraph 13.[13] HKSA 706 (Revised) provides further guidance on the relationship between key audit matters and Emphasis of Matter paragraphs in accordance with that HKSA.[14]

Determining Key Audit Matters (Ref: Para. 9–10)

A9. The auditor's decision-making process in determining key audit matters is designed to select a smaller number of matters from the matters communicated with those charged with governance, based on the auditor's judgment about which matters were of most significance in the audit of the financial statements of the current period.

A10. The auditor's determination of key audit matters is limited to those matters of most significance in the audit of the financial statements of the current period, even when comparative financial statements are presented (i.e., even when the auditor's opinion refers to each period for which financial statements are presented).[15]

A11. Notwithstanding that the auditor's determination of key audit matters is for the audit of the financial statements of the current period and this HKSA does not require the auditor to update key audit matters included in the prior period's auditor's report, it may nevertheless be useful for the auditor to consider whether a matter that was a key audit matter in the audit of the financial statements of the prior period continues to be a key audit matter in the audit of the financial statements of the current period.

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[11] HKSA 705 (Revised), paragraph 8

[12] HKSA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*

[13] See paragraphs 8(b) and 10(b) of HKSA 706 (Revised).

[14] HKSA 706 (Revised), paragraphs A1–A3

[15] See HKSA 710, *Comparative Information—Corresponding Figures and Comparative Financial Statements*.

Matters that Required Significant Auditor Attention (Ref: Para. 9)

A12. The concept of significant auditor attention recognizes that an audit is risk-based and focuses on identifying and assessing the risks of material misstatement of the financial statements, designing and performing audit procedures responsive to those risks, and obtaining audit evidence that is sufficient and appropriate to provide a basis for the auditor's opinion. For a particular account balance, class of transactions or disclosure, the higher an assessed risk of material misstatement at the assertion level, the more judgment is often involved in planning and performing the audit procedures and evaluating the results thereof. In designing further audit procedures, the auditor is required to obtain more persuasive audit evidence the higher the auditor's assessment of risk.[16] When obtaining more persuasive audit evidence because of a higher assessment of risk, the auditor may increase the quantity of the evidence, or obtain evidence that is more relevant or reliable, for example, by placing more emphasis on obtaining third party evidence or by obtaining corroborating evidence from a number of independent sources.[17]

A13. Accordingly, matters that pose challenges to the auditor in obtaining sufficient appropriate audit evidence or pose challenges to the auditor in forming an opinion on the financial statements may be particularly relevant in the auditor's determination of key audit matters.

A14. Areas of significant auditor attention often relate to areas of complexity and significant management judgment in the financial statements, and therefore often involve difficult or complex auditor judgments. In turn, this often affects the auditor's overall audit strategy, the allocation of resources and extent of audit effort in relation to such matters. These effects may include, for example, the extent of involvement of senior personnel on the audit engagement or the involvement of an auditor's expert or individuals with expertise in a specialized area of accounting or auditing, whether engaged or employed by the firm to address these areas.

A15. Various HKSAs require specific communications with those charged with governance and others that may relate to areas of significant auditor attention. For example:

- HKSA 260 (Revised) requires the auditor to communicate significant difficulties, if any, encountered during the audit with those charged with governance.[18] The HKSAs acknowledge potential difficulties in relation to, for example:
  - Related party transactions,[19] in particular limitations on the auditor's ability to obtain audit evidence that all other aspects of a related party transaction (other than price) are equivalent to those of a similar arm's length transaction.
  - Limitations on the group audit, for example, where the group engagement team's access to information may have been restricted.[20]
- HKSA 220 establishes requirements for the engagement partner in relation to undertaking appropriate consultation on difficult or contentious matters.[21] For example, the auditor may have consulted with others within the firm or outside the firm on a significant technical matter, which may be an indicator that it is a key audit matter. The

[16] HKSA 330, *The Auditor's Responses to Assessed Risks*, paragraph 7(b)

[17] HKSA 330, paragraph A19

[18] HKSA 260 (Revised), paragraphs 16(b) and A21

[19] HKSA 550, *Related Parties*, paragraph A42

[20] HKSA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, paragraph 49(d)

[21] HKSA 220, *Quality Control for an Audit of Financial Statements*, paragraph 18

engagement partner is also required to discuss, among other things, significant matters arising during the audit engagement with the engagement quality control reviewer.[22]

Considerations in Determining Those Matters that Required Significant Auditor Attention (Ref: Para. 9)

A16. The auditor may develop a preliminary view at the planning stage about matters that are likely to be areas of significant auditor attention in the audit and therefore may be key audit matters. The auditor may communicate this with those charged with governance when discussing the planned scope and timing of the audit in accordance with HKSA 260 (Revised). However, the auditor's determination of key audit matters is based on the results of the audit or evidence obtained throughout the audit.

A17. Paragraph 9 includes specific required considerations in the auditor's determination of those matters that required significant auditor attention. These considerations focus on the nature of matters communicated with those charged with governance that are often linked to matters disclosed in the financial statements, and are intended to reflect areas of the audit of the financial statements that may be of particular interest to intended users. The fact that these considerations are required is not intended to imply that matters related to them are always key audit matters; rather, matters related to such specific considerations are key audit matters only if they are determined to be of most significance in the audit in accordance with paragraph 10. As the considerations may be interrelated (e.g., matters relating to the circumstances described in paragraphs 9(b)-(c) may also be identified as significant risks), the applicability of more than one of the considerations to a particular matter communicated with those charged with governance may increase the likelihood of the auditor identifying that matter as a key audit matter.

A18. In addition to matters that relate to the specific required considerations in paragraph 9, there may be other matters communicated with those charged with governance that required significant auditor attention and that therefore may be determined to be key audit matters in accordance with paragraph 10. Such matters may include, for example, matters relevant to the audit that was performed that may not be required to be disclosed in the financial statements. For example, the implementation of a new IT system (or significant changes to an existing IT system) during the period may be an area of significant auditor attention, in particular if such a change had a significant effect on the auditor's overall audit strategy or related to a significant risk (e.g., changes to a system affecting revenue recognition).

Areas of Higher Assessed Risk of Material Misstatement, or Significant Risks Identified in Accordance with HKSA 315 (Revised) (Ref: Para. 9(a))

A19. HKSA 260 (Revised) requires the auditor to communicate with those charged with governance about the significant risks identified by the auditor.[23] Paragraph A13 of HKSA 260 (Revised) explains that the auditor may also communicate with those charged with governance about how the auditor plans to address areas of higher assessed risks of material misstatement.

A20. HKSA 315 (Revised) defines a significant risk as an identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration. Areas of significant management judgment and significant unusual transactions may often be identified as significant risks. Significant risks are therefore often areas that require significant auditor attention.

[22] HKSA 220, paragraph 19

[23] HKSA 260 (Revised), paragraph 15

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 Have Been Identified as Having High 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 have been identified as having high estimation uncertainty in accordance with HKSA 540[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

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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 10–11 of HKSA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*.

governance at various stages throughout the audit about the effect on the financial statements of significant transactions with related parties or significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual.[29] Management may have made difficult or complex judgments in relation to recognition, measurement, presentation or disclosure of such transactions, which may have had a significant effect on the auditor's overall strategy.

A26. Significant economic, accounting, regulatory, industry, or other developments that affected management's assumptions or judgments may also affect the auditor's overall approach to the audit and result in a matter requiring significant auditor attention.

Matters of Most Significance (Ref: Para. 10)

A27. Matters that required significant auditor attention also may have resulted in significant interaction with those charged with governance. The nature and extent of communication about such matters with those charged with governance often provides an indication of which matters are of most significance in the audit. For example, the auditor may have had more in-depth, frequent or robust interactions with those charged with governance on more difficult and complex matters, such as the application of significant accounting policies that were the subject of significant auditor or management judgment.

A28. The concept of matters of most significance is applicable in the context of the entity and the audit that was performed. As such, the auditor's determination and communication of key audit matters is intended to identify matters specific to the audit and to involve making a judgment about their importance relative to other matters in the audit.

A29. Other considerations that may be relevant to determining the relative significance of a matter communicated with those charged with governance and whether such a matter is a key audit matter include:

- The importance of the matter to intended users' understanding of the financial statements as a whole, in particular, its materiality to the financial statements.
- The nature of the underlying accounting policy relating to the matter or the complexity or subjectivity involved in management's selection of an appropriate policy compared to other entities within its industry.
- The nature and materiality, quantitatively or qualitatively, of corrected and accumulated uncorrected misstatements due to fraud or error related to the matter, if any.
- The nature and extent of audit effort needed to address the matter, including:
    - The extent of specialized skill or knowledge needed to apply audit procedures to address the matter or evaluate the results of those procedures, if any.
    - The nature of consultations outside the engagement team regarding the matter.
- The nature and severity of difficulties in applying audit procedures, evaluating the results of those procedures, and obtaining relevant and reliable evidence on which to base the auditor's opinion, in particular as the auditor's judgments become more subjective.
- The severity of any control deficiencies identified relevant to the matter.

[29] See paragraphs 16(a), 16(c) and A22, and Appendix 2, of HKSA 260 (Revised).

- Whether the matter involved a number of separate, but related, auditing considerations. For example, long-term contracts may involve significant auditor attention with respect to revenue recognition, litigation or other contingencies, and may have an effect on other accounting estimates.

A30. Determining which, and how many, of those matters that required significant auditor attention were of most significance in the audit of the financial statements of the current period is a matter of professional judgment. The number of key audit matters to be included in the auditor's report may be affected by the size and complexity of the entity, the nature of its business and environment, and the facts and circumstances of the audit engagement. In general, the greater the number of matters initially determined to be key audit matters, the more the auditor may need to reconsider whether each of these matters meets the definition of a key audit matter. Lengthy lists of key audit matters may be contrary to the notion of such matters being those of most significance in the audit.

Communicating Key Audit Matters

Separate Key Audit Matters Section in the Auditor's Report (Ref: Para. 11)

A31. Placing the separate Key Audit Matters section in close proximity to the auditor's opinion may give prominence to such information and acknowledge the perceived value of engagement-specific information to intended users.

A32. The order of presentation of individual matters within the Key Audit Matters section is a matter of professional judgment. For example, such information may be organized in order of relative importance, based on the auditor's judgment, or may correspond to the manner in which matters are disclosed in the financial statements. The requirement in paragraph 11 to include subheadings is intended to further differentiate the matters.

A33. When comparative financial information is presented, the introductory language of the Key Audit Matters section is tailored to draw attention to the fact that the key audit matters described relate to only the audit of the financial statements of the current period, and may include reference to the specific period covered by those financial statements (e.g., "for the year ended 31 December 20X1").

Descriptions of Individual Key Audit Matters (Ref: Para. 13)

A34. The adequacy of the description of a key audit matter is a matter of professional judgment. The description of a key audit matter is intended to provide a succinct and balanced explanation to enable intended users to understand why the matter was one of most significance in the audit and how the matter was addressed in the audit. Limiting the use of highly technical auditing terms also helps to enable intended users who do not have a reasonable knowledge of auditing to understand the basis for the auditor's focus on particular matters during the audit. The nature and extent of information provided by the auditor is intended to be balanced in the context of the responsibilities of the respective parties (i.e., for the auditor to provide useful information in a concise and understandable form, while not inappropriately being the provider of original information about the entity).

A35. Original information is any information about the entity that has not otherwise been made publicly available by the entity (e.g., has not been included in the financial statements or other information available at the date of the auditor's report, or addressed in other oral or written communications by management or those charged with governance, such as a preliminary announcement of financial information or investor briefings). Such information is the responsibility of the entity's management and those charged with governance.

A36. It is appropriate for the auditor to seek to avoid the description of a key audit matter inappropriately providing original information about the entity. The description of a key audit matter is not usually of itself original information about the entity, as it describes the matter in the context of the audit. However, the auditor may consider it necessary to include additional information to explain why the matter was considered to be one of most significance in the audit and therefore determined to be a key audit matter, and how the matter was addressed in the audit, provided that disclosure of such information is not precluded by law or regulation. When such information is determined to be necessary by the auditor, the auditor may encourage management or those charged with governance to disclose additional information, rather than the auditor providing original information in the auditor's report.

A37. Management or those charged with governance may decide to include new or enhanced disclosures in the financial statements or elsewhere in the annual report relating to a key audit matter in light of the fact that the matter will be communicated in the auditor's report. Such new or enhanced disclosures, for example, may be included to provide more robust information about the sensitivity of key assumptions used in accounting estimates or the entity's rationale for a particular accounting practice or policy when acceptable alternatives exist under the applicable financial reporting framework.

A38. HKSA 720 (Revised) defines the term annual report and explains that documents such as a management report, management commentary, or operating and financial review or similar reports by those charged with governance (e.g., a directors’ report); a Chairman’s statement; corporate governance statement; or internal control and risk assessment reports may form part of the annual report.[30] HKSA 720 (Revised) addresses the auditor’s responsibilities relating to other information included in the annual report. Although the auditor's opinion on the financial statements does not cover the other information, the auditor may consider this information, as well as other publicly available communications by the entity or other credible sources, in formulating the description of a key audit matter.

A39. Audit documentation prepared during the audit can also be useful to the auditor in formulating the description of a key audit matter. For example, written communications, or the auditor's documentation of oral communications, with those charged with governance and other audit documentation provides a useful basis for the auditor's communication in the auditor's report. This is because audit documentation in accordance with HKSA 230 is intended to address the significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions, and serves as a record of the nature, timing and extent of the audit procedures performed, the results of those procedures, and the audit evidence obtained. Such documentation may assist the auditor in developing a description of key audit matters that explains the significance of the matter and also in applying the requirement in paragraph 18.

Reference to Where the Matter Is Disclosed in the Financial Statements (Ref: Para. 13)

A40. Paragraphs 13(a)-(b) requires the description of each key audit matter to address why the auditor considered the matter to be one of most significance in the audit and how the matter was addressed in the audit. Accordingly, the description of key audit matters is not a mere reiteration of what is disclosed in the financial statements. However, a reference to any related disclosures enables intended users to further understand how management has addressed the matter in preparing the financial statements.

[30] HKSA 720 (Revised), *The Auditor’s Responsibilities Relating to Other Information*, paragraphs 12(a) and A1–A3

A41. In addition to referring to related disclosure(s), the auditor may draw attention to key aspects of them. The extent of disclosure by management about specific aspects or factors in relation to how a particular matter is affecting the financial statements of the current period may help the auditor in pinpointing particular aspects of how the matter was addressed in the audit such that intended users can understand why the matter is a key audit matter. For example:

- When an entity includes robust disclosure about accounting estimates, the auditor may draw attention to the disclosure of key assumptions, the disclosure of the range of possible outcomes, and other qualitative and quantitative disclosures relating to key sources of estimation uncertainty or critical accounting estimates, as part of addressing why the matter was one of most significance in the audit and how the matter was addressed in the audit.
- When the auditor concludes in accordance with HKSA 570 (Revised) that no material uncertainty exists relating to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern, the auditor may nevertheless determine that one or more matters relating to this conclusion arising from the auditor's work effort under HKSA 570 (Revised) are key audit matters. In such circumstances, the auditor's description of such key audit matters in the auditor's report could include aspects of the identified events or conditions disclosed in the financial statements, such as substantial operating losses, available borrowing facilities and possible debt refinancing, or non-compliance with loan agreements, and related mitigating factors.[31]

Why the Auditor Considered the Matter to Be One of Most Significance in the Audit (Ref: Para. 13(a))

A42. The description of a key audit matter in the auditor's report is intended to provide insight as to why the matter was determined to be a key audit matter. Accordingly, the requirements in paragraphs 9–10 and the application material in paragraphs A12–A29 related to determining key audit matters may also be helpful for the auditor in considering how such matters are to be communicated in the auditor's report. For example, explaining the factors that led the auditor to conclude that a particular matter required significant auditor attention and was of most significance in the audit is likely to be of interest to intended users.

A43. The relevance of the information for intended users is a consideration for the auditor in determining what to include in the description of a key audit matter. This may include whether the description would enable a better understanding of the audit and the auditor's judgments.

A44. Relating a matter directly to the specific circumstances of the entity may also help to minimize the potential that such descriptions become overly standardized and less useful over time. For example, certain matters may be determined as key audit matters in a particular industry across a number of entities due to the circumstances of the industry or the underlying complexity in financial reporting. In describing why the auditor considered the matter to be one of most significance, it may be useful for the auditor to highlight aspects specific to the entity (e.g., circumstances that affected the underlying judgments made in the financial statements of the current period) in order to make the description more relevant for intended users. This also may be important in describing a key audit matter that recurs over periods.

[31] See paragraph A3 of HKSA 570 (Revised).

A45. The description may also make reference to the principal considerations that led the auditor, in the circumstances of the audit, to determine the matter to be one of most significance, for example:

- Economic conditions that affected the auditor's ability to obtain audit evidence, for example illiquid markets for certain financial instruments.
- New or emerging accounting policies, for example entity-specific or industry-specific matters on which the engagement team consulted within the firm.
- Changes in the entity's strategy or business model that had a material effect on the financial statements.

How the Matter Was Addressed in the Audit (Ref: Para. 13(b))

A46. The amount of detail to be provided in the auditor's report to describe how a key audit matter was addressed in the audit is a matter of professional judgment. In accordance with paragraph 13(b), the auditor may describe:

- Aspects of the auditor's response or approach that were most relevant to the matter or specific to the assessed risk of material misstatement;
- A brief overview of procedures performed;
- An indication of the outcome of the auditor's procedures; or
- Key observations with respect to the matter,

or some combination of these elements.

Law or regulation or HKSAs may prescribe a specific form or content for the description of a key audit matter, or may specify the inclusion of one or more of these elements.

A47. In order for intended users to understand the significance of a key audit matter in the context of the audit of the financial statements as a whole, as well as the relationship between key audit matters and other elements of the auditor's report, including the auditor's opinion, care may be necessary so that language used in the description of a key audit matter:

- Does not imply that the matter has not been appropriately resolved by the auditor in forming the opinion on the financial statements.
- Relates the matter directly to the specific circumstances of the entity, while avoiding generic or standardized language.
- Takes into account how the matter is addressed in the related disclosure(s) in the financial statements, if any.
- Does not contain or imply discrete opinions on separate elements of the financial statements.

A48. Describing aspects of the auditor's response or approach to a matter, in particular when the audit approach required significant tailoring to the facts and circumstances of the entity, may assist intended users in understanding unusual circumstances and significant auditor judgment required to address the risk of material misstatement. In addition, the audit approach in a particular period may have been influenced by entity-specific circumstances, economic conditions, or industry developments. It may also be useful for the auditor to make reference to the nature and extent of communications with those charged with governance about the matter.

A49. For example, in describing the auditor's approach to an accounting estimate that has been identified as having high estimation uncertainty, such as the valuation of complex financial instruments, the auditor may wish to highlight that the auditor employed or engaged an auditor's expert. Such a reference to the use of an auditor's expert does not reduce the auditor's responsibility for the opinion on the financial statements and is therefore not inconsistent with paragraphs 14–15 of HKSA 620.[32]

A50. There may be challenges in describing the auditor's procedures, particularly in complex, judgmental areas of the audit. In particular, it may be difficult to summarize the procedures performed in a succinct way that adequately communicates the nature and extent of the auditor's response to the assessed risk of material misstatement, and the significant auditor judgments involved. Nonetheless, the auditor may consider it necessary to describe certain procedures performed to communicate how the matter was addressed in the audit. Such description may typically be at a high level, rather than include a detailed description of procedures.

A51. As noted in paragraph A46, the auditor may also provide an indication of the outcome of the auditor's response in the description of the key audit matter in the auditor's report. However, if this is done, care is needed to avoid the auditor giving the impression that the description is conveying a separate opinion on an individual key audit matter or that in any way may call into question the auditor's opinion on the financial statements as a whole.

Circumstances in Which a Matter Determined to Be a Key Audit Matter Is Not Communicated in the Auditor's Report (Ref: Para. 14)

A52. Law or regulation may preclude public disclosure by either management or the auditor about a specific matter determined to be a key audit matter. For example, law or regulation may specifically prohibit any public communication that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act (e.g., matters that are or appear to be related to money laundering).

A53. As indicated by paragraph 14(b), it will be extremely rare for a matter determined to be a key audit matter not to be communicated in the auditor's report. This is because there is presumed to be a public interest benefit in providing greater transparency about the audit for intended users. Accordingly, the judgment not to communicate a key audit matter is appropriate only in cases when the adverse consequences to the entity or the public as a result of such communication are viewed as so significant that they would reasonably be expected to outweigh the public interest benefits of communicating about the matter.

A54. The determination not to communicate a key audit matter takes into account the facts and circumstances related to the matter. Communication with management and those charged with governance helps the auditor understand management's views about the significance of the adverse consequences that may arise as a result of communicating about a matter. In particular, communication with management and those charged with governance helps to inform the auditor's judgment in determining whether to communicate the matter by:

- Assisting the auditor in understanding why the matter has not been publicly disclosed by the entity (e.g., if law, regulation or certain financial reporting frameworks permit delayed disclosure or non-disclosure of the matter) and management's views as to the adverse consequences, if any, of disclosure. Management may draw attention to certain aspects in law or regulation or other authoritative sources that may be relevant to the

[32] HKSA 620, *Using the Work of an Auditor's Expert*

consideration of adverse consequences (e.g., such aspects may include harm to the entity's commercial negotiations or competitive position). However, management's views about the adverse consequences alone do not alleviate the need for the auditor to determine whether the adverse consequences would reasonably be expected to outweigh the public interest benefits of communication in accordance with paragraph 14(b).

- Highlighting whether there have been any communications with applicable regulatory, enforcement or supervisory authorities in relation to the matter, in particular whether such discussions would appear to support management's assertion as to why public disclosure about the matter is not appropriate.
- Enabling the auditor, where appropriate, to encourage management and those charged with governance to make public disclosure of relevant information about the matter. In particular, this may be possible if the concerns of management and those charged with governance about communicating are limited to specific aspects relating to the matter, such that certain information about the matter may be less sensitive and could be communicated.

The auditor also may consider it necessary to obtain a written representation from management as to why public disclosure about the matter is not appropriate, including management's view about the significance of the adverse consequences that may arise as a result of such communication.

A55. It may also be necessary for the auditor to consider the implications of communicating about a matter determined to be a key audit matter in light of relevant ethical requirements. In addition, the auditor may be required by law or regulation to communicate with applicable regulatory, enforcement or supervisory authorities in relation to the matter, regardless of whether the matter is communicated in the auditor's report. Such communication may also be useful to inform the auditor's consideration of the adverse consequences that may arise from communicating about the matter.

A56. The issues considered by the auditor regarding a decision to not communicate a matter are complex and involve significant auditor judgment. Accordingly, the auditor may consider it appropriate to obtain legal advice.

Form and Content of the Key Audit Matters Section in Other Circumstances (Ref: Para. 16)

A57. The requirement in paragraph 16 applies in three circumstances:

(i) The auditor determines in accordance with paragraph 10 that there are no key audit matters (see paragraph A59).

(ii) The auditor determines in accordance with paragraph 14 that a key audit matter will not be communicated in the auditor's report and no other matters have been determined to be key audit matters.

(iii) The only matters determined to be key audit matters are those communicated in accordance with paragraph 15.

A58. The following illustrates the presentation in the auditor's report if the auditor has determined there are no key audit matters to communicate:

> **Key Audit Matters**
>
> [Except for the matter described in the *Basis for Qualified (Adverse) Opinion* section or *Material Uncertainty Related to Going Concern* section,] We have determined that there are no [other] key audit matters to communicate in our report.

A59. The determination of key audit matters involves making a judgment about the relative importance of matters that required significant auditor attention. Therefore, it may be rare that the auditor of a complete set of general purpose financial statements of a listed entity would not determine at least one key audit matter from the matters communicated with those charged with governance to be communicated in the auditor's report. However, in certain limited circumstances (e.g., for a listed entity that has very limited operations), the auditor may determine that there are no key audit matters in accordance with paragraph 10 because there are no matters that required significant auditor attention.

Communication with Those Charged with Governance (Ref: Para. 17)

A60. HKSA 260 (Revised) requires the auditor to communicate with those charged with governance on a timely basis.[33] The appropriate timing for communications about key audit matters will vary with the circumstances of the engagement. However, the auditor may communicate preliminary views about key audit matters when discussing the planned scope and timing of the audit, and may further discuss such matters when communicating about audit findings. Doing so may help to alleviate the practical challenges of attempting to have a robust two-way dialogue about key audit matters at the time the financial statements are being finalized for issuance.

A61. Communication with those charged with governance enables them to be made aware of the key audit matters that the auditor intends to communicate in the auditor's report, and provides them with an opportunity to obtain further clarification where necessary. The auditor may consider it useful to provide those charged with governance with a draft of the auditor's report to facilitate this discussion. Communication with those charged with governance recognizes their important role in overseeing the financial reporting process, and provides the opportunity for those charged with governance to understand the basis for the auditor's decisions in relation to key audit matters and how these matters will be described in the auditor's report. It also enables those charged with governance to consider whether new or enhanced disclosures may be useful in light of the fact that these matters will be communicated in the auditor's report.

A62. The communication with those charged with governance required by paragraph 17(a) also addresses the extremely rare circumstances in which a matter determined to be a key audit matter is not communicated in the auditor's report (see paragraphs 14 and A54).

A63. The requirement in paragraph 17(b) to communicate with those charged with governance when the auditor has determined there are no key audit matters to communicate in the auditor's report may provide an opportunity for the auditor to have further discussion with others who are familiar with the audit and the significant matters that may have arisen (including the engagement quality control reviewer, where one has been appointed). These discussions may cause the auditor to re-evaluate the auditor's determination that there are no key audit matters.

[33] HKSA 260 (Revised), paragraph 21

Documentation (Ref: Para. 18)

A64. Paragraph 8 of HKSA 230 requires the auditor to prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand, among other things, significant professional judgments. In the context of key audit matters, these professional judgments include the determination, from the matters communicated with those charged with governance, of the matters that required significant auditor attention, as well as whether or not each of those matters is a key audit matter. The auditor's judgments in this regard are likely to be supported by the documentation of the auditor's communications with those charged with governance and the audit documentation relating to each individual matter (see paragraph A39), as well as certain other audit documentation of the significant matters arising during the audit (e.g., a completion memorandum). However, this HKSA does not require the auditor to document why other matters communicated with those charged with governance were not matters that required significant auditor attention.

HKSA 705 (Revised)
Issued August 2015

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

Hong Kong Standard on Auditing 705 (Revised)

Modifications to the Opinion In the Independent Auditor's Report

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

HONG KONG STANDARD ON AUDITING 705 (REVISED) MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT

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

CONTENTS

Hong Kong Standard on Auditing (HKSA) 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*, should be read in conjunction with HKSA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing*.

Introduction

Scope of this HKSA

1. This Hong Kong Standard on Auditing (HKSA) deals with the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with HKSA 700 (Revised),[1] the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary. This HKSA also deals with how the form and content of the auditor's report is affected when the auditor expresses a modified opinion. In all cases, the reporting requirements in HKSA 700 (Revised) apply, and are not repeated in this HKSA unless they are explicitly addressed or amended by the requirements of this HKSA.

Types of Modified Opinions

2. This HKSA establishes three types of modified opinions, namely, a qualified opinion, an adverse opinion, and a disclaimer of opinion. The decision regarding which type of modified opinion is appropriate depends upon:

    (a) The nature of the matter giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated; and

    (b) The auditor's judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements. (Ref: Para. A1)

Effective Date

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

Objective

4. The objective of the auditor is to express clearly an appropriately modified opinion on the financial statements that is necessary when:

    (a) The auditor concludes, based on the audit evidence obtained, that the financial statements as a whole are not free from material misstatement; or

    (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

Definitions

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

    (a) Pervasive – A term used, in the context of misstatements, to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate audit evidence. Pervasive effects on the financial statements are those that, in the auditor's judgment:

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

(i) Are not confined to specific elements, accounts or items of the financial statements;

(ii) If so confined, represent or could represent a substantial proportion of the financial statements; or

(iii) In relation to disclosures, are fundamental to users' understanding of the financial statements.

(b) Modified opinion – A qualified opinion, an adverse opinion or a disclaimer of opinion on the financial statements.

Requirements

Circumstances When a Modification to the Auditor's Opinion Is Required

6. The auditor shall modify the opinion in the auditor's report when:

   (a) The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or (Ref: Para. A2–A7)

   (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement. (Ref: Para. A8–A12)

Determining the Type of Modification to the Auditor's Opinion

Qualified Opinion

7. The auditor shall express a qualified opinion when:

   (a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or

   (b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

Adverse Opinion

8. The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

Disclaimer of Opinion

9. The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

10. The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management-Imposed Limitation after the Auditor Has Accepted the Engagement

11. If, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor shall request that management remove the limitation.

12. If management refuses to remove the limitation referred to in paragraph 11 of this HKSA, the auditor shall communicate the matter to those charged with governance, unless all of those charged with governance are involved in managing the entity,[2] and determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence.

13. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall determine the implications as follows:

    (a) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor shall qualify the opinion; or

    (b) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall:

        (i) Withdraw from the audit, where practicable and possible under applicable law or regulation; or (Ref: Para. A13)

        (ii) If withdrawal from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial statements. (Ref. Para. A14)

14. If the auditor withdraws as contemplated by paragraph 13(b)(i), before withdrawing, the auditor shall communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion. (Ref: Para. A15)

Other Considerations Relating to an Adverse Opinion or Disclaimer of Opinion

15. When the auditor considers it necessary to express an adverse opinion or disclaim an opinion on the financial statements as a whole, the auditor's report shall not also include an unmodified opinion with respect to the same financial reporting framework on a single financial statement or one or more specific elements, accounts or items of a financial statement. To include such an unmodified opinion in the same report[3] in these circumstances would contradict the auditor's adverse opinion or disclaimer of opinion on the financial statements as a whole. (Ref: Para. A16)

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[2] HKSA 260 (Revised), *Communication with Those Charged with Governance*, paragraph 13

[3] HKSA 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement*, deals with circumstances where the auditor is engaged to express a separate opinion on one or more specific elements, accounts or items of a financial statement.

Form and Content of the Auditor's Report When the Opinion Is Modified

Auditor's Opinion

16. When the auditor modifies the audit opinion, the auditor shall use the heading "Qualified Opinion," "Adverse Opinion," or "Disclaimer of Opinion," as appropriate, for the Opinion section. (Ref: Para. A17–A19)

Qualified Opinion

17. When the auditor expresses a qualified opinion due to a material misstatement in the financial statements, the auditor shall state that, in the auditor's opinion, except for the effects of the matter(s) described in the Basis for Qualified Opinion section:

    (a) When reporting in accordance with a fair presentation framework, the accompanying financial statements present fairly, in all material respects (or give a true and fair view of) […] in accordance with [the applicable financial reporting framework]; or

    (b) When reporting in accordance with a compliance framework, the accompanying financial statements have been prepared, in all material respects, in accordance with [the applicable financial reporting framework].

    When the modification arises from an inability to obtain sufficient appropriate audit evidence, the auditor shall use the corresponding phrase "except for the possible effects of the matter(s) ..." for the modified opinion. (Ref: Para. A20)

Adverse Opinion

18. When the auditor expresses an adverse opinion, the auditor shall state that, in the auditor's opinion, because of the significance of the matter(s) described in the Basis for Adverse Opinion section:

    (a) When reporting in accordance with a fair presentation framework, the accompanying financial statements do not present fairly (or give a true and fair view of) […] in accordance with [the applicable financial reporting framework]; or

    (b) When reporting in accordance with a compliance framework, the accompanying financial statements have not been prepared, in all material respects, in accordance with [the applicable financial reporting framework].

Disclaimer of Opinion

19. When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor shall:

    (a) State that the auditor does not express an opinion on the accompanying financial statements;

    (b) State that, because of the significance of the matter(s) described in the Basis for Disclaimer of Opinion section, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements; and

    (c) Amend the statement required by paragraph 24(b) of HKSA 700 (Revised), which indicates that the financial statements have been audited, to state that the auditor was engaged to audit the financial statements.

Basis for Opinion

20. When the auditor modifies the opinion on the financial statements, the auditor shall, in addition to the specific elements required by HKSA 700 (Revised): (Ref: Para. A21)

    (a) Amend the heading "Basis for Opinion" required by paragraph 28 of HKSA 700 (Revised) to "Basis for Qualified Opinion," "Basis for Adverse Opinion," or "Basis for Disclaimer of Opinion," as appropriate; and

    (b) Within this section, include a description of the matter giving rise to the modification.

21. If there is a material misstatement of the financial statements that relates to specific amounts in the financial statements (including quantitative disclosures in the notes to the financial statements), the auditor shall include in the Basis for Opinion section a description and quantification of the financial effects of the misstatement, unless impracticable. If it is not practicable to quantify the financial effects, the auditor shall so state in this section. (Ref: Para. A22)

22. If there is a material misstatement of the financial statements that relates to narrative disclosures, the auditor shall include in the Basis for Opinion section an explanation of how the disclosures are misstated.

23. If there is a material misstatement of the financial statements that relates to the non-disclosure of information required to be disclosed, the auditor shall:

    (a) Discuss the non-disclosure with those charged with governance;

    (b) Describe in the Basis for Opinion section the nature of the omitted information; and

    (c) Unless prohibited by law or regulation, include the omitted disclosures, provided it is practicable to do so and the auditor has obtained sufficient appropriate audit evidence about the omitted information. (Ref: Para. A23)

24. If the modification results from an inability to obtain sufficient appropriate audit evidence, the auditor shall include in the Basis for Opinion section the reasons for that inability.

25. When the auditor expresses a qualified or adverse opinion, the auditor shall amend the statement about whether the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor's opinion required by paragraph 28(d) of HKSA 700 (Revised) to include the word "qualified" or "adverse", as appropriate.

26. When the auditor disclaims an opinion on the financial statements, the auditor's report shall not include the elements required by paragraphs 28(b) and 28(d) of HKSA 700 (Revised). Those elements are:

    (a) A reference to the section of the auditor's report where the auditor's responsibilities are described; and

    (b) A statement about whether the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

27. Even if the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements, the auditor shall describe in the Basis for Opinion section the reasons for any other matters of which the auditor is aware that would have required a modification to the opinion, and the effects thereof. (Ref: Para. A24)

Description of Auditor's Responsibilities for the Audit of the Financial Statements When the Auditor Disclaims an Opinion on the Financial Statements

28. When the auditor disclaims an opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence, the auditor shall amend the description of the auditor's responsibilities required by paragraphs 38–40 of HKSA 700 (Revised) to include only the following: (Ref: Para. A25)

    (a) A statement that the auditor's responsibility is to conduct an audit of the entity's financial statements in accordance with Hong Kong Standards on Auditing and to issue an auditor's report[3a];

    (b) A statement that, however, because of the matter(s) described in the Basis for Disclaimer of Opinion section, the auditor was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements; and

    (c) The statement about auditor independence and other ethical responsibilities required by paragraph 28(c) of HKSA 700 (Revised).

Considerations When the Auditor Disclaims an Opinion on the Financial Statements

29. Unless required by law or regulation, when the auditor disclaims an opinion on the financial statements, the auditor's report shall not include a Key Audit Matters section in accordance with HKSA 701[4] or an Other Information section in accordance with HKSA 720 (Revised).[5] (Ref: Para. A26)

Communication with Those Charged with Governance

30. When the auditor expects to modify the opinion in the auditor's report, the auditor shall communicate with those charged with governance the circumstances that led to the expected modification and the wording of the modification. (Ref: Para. A27)

Conformity and Compliance with International Standards on Auditing

31. As of August 2015 (date of issue), this HKSA conforms with International Standard on Auditing (ISA) 705 (Revised) *Modifications to the Opinion in the Independent Auditor's Report.* Compliance with the requirements of this HKSA ensures compliance with ISA 705 (Revised).

32. Additional local guidance is provided in Appendix.

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4 HKSA 701, *Communicating Key Audit Matters in the Independent Auditor's Report,* paragraphs 11–13

5 HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*, paragraph A54

Application and Other Explanatory Material

Types of Modified Opinions (Ref: Para. 2)

A1. The table below illustrates how the auditor's judgment about the nature of the matter giving rise to the modification, and the pervasiveness of its effects or possible effects on the financial statements, affects the type of opinion to be expressed.

Nature of Matter Giving Rise to the Modification	*Auditor's Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements*	
	Material but Not Pervasive	*Material and Pervasive*
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

Circumstances When a Modification to the Auditor's Opinion Is Required

Nature of Material Misstatements (Ref: Para. 6(a))

A2. HKSA 700 (Revised) requires the auditor, in order to form an opinion on the financial statements, to conclude as to whether reasonable assurance has been obtained about whether the financial statements as a whole are free from material misstatement.[6] This conclusion takes into account the auditor's evaluation of uncorrected misstatements, if any, on the financial statements in accordance with HKSA 450.[7]

A3. HKSA 450 defines a misstatement as a difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Accordingly, a material misstatement of the financial statements may arise in relation to:

(a) The appropriateness of the selected accounting policies;

(b) The application of the selected accounting policies; or

(c) The appropriateness or adequacy of disclosures in the financial statements.

Appropriateness of the Selected Accounting Policies

A4. In relation to the appropriateness of the accounting policies management has selected, material misstatements of the financial statements may arise when:

(a) The selected accounting policies are not consistent with the applicable financial reporting framework; or

[6] HKSA 700 (Revised), paragraph 11

[7] HKSA 450, *Evaluation of Misstatements Identified during the Audit*, paragraph 11

(b) The financial statements, including the related notes, do not represent the underlying transactions and events in a manner that achieves fair presentation.

A5. Financial reporting frameworks often contain requirements for the accounting for, and disclosure of, changes in accounting policies. Where the entity has changed its selection of significant accounting policies, a material misstatement of the financial statements may arise when the entity has not complied with these requirements.

Application of the Selected Accounting Policies

A6. In relation to the application of the selected accounting policies, material misstatements of the financial statements may arise:

(a) When management has not applied the selected accounting policies consistently with the financial reporting framework, including when management has not applied the selected accounting policies consistently between periods or to similar transactions and events (consistency in application); or

(b) Due to the method of application of the selected accounting policies (such as an unintentional error in application).

Appropriateness or Adequacy of Disclosures in the Financial Statements

A7. In relation to the appropriateness or adequacy of disclosures in the financial statements, material misstatements of the financial statements may arise when:

(a) The financial statements do not include all of the disclosures required by the applicable financial reporting framework;

(b) The disclosures in the financial statements are not presented in accordance with the applicable financial reporting framework; or

(c) The financial statements do not provide the disclosures necessary to achieve fair presentation.

Nature of an Inability to Obtain Sufficient Appropriate Audit Evidence (Ref: Para. 6(b))

A8. The auditor's inability to obtain sufficient appropriate audit evidence (also referred to as a limitation on the scope of the audit) may arise from:

(a) Circumstances beyond the control of the entity;

(b) Circumstances relating to the nature or timing of the auditor's work; or

(c) Limitations imposed by management.

A9. An inability to perform a specific procedure does not constitute a limitation on the scope of the audit if the auditor is able to obtain sufficient appropriate audit evidence by performing alternative procedures. If this is not possible, the requirements of paragraphs 7(b) and 9–10 apply as appropriate. Limitations imposed by management may have other implications for the audit, such as for the auditor's assessment of fraud risks and consideration of engagement continuance.

A10. Examples of circumstances beyond the control of the entity include when:

- The entity's accounting records have been destroyed.
- The accounting records of a significant component have been seized indefinitely by governmental authorities.

A11. Examples of circumstances relating to the nature or timing of the auditor's work include when:

- The entity is required to use the equity method of accounting for an associated entity, and the auditor is unable to obtain sufficient appropriate audit evidence about the latter's financial information to evaluate whether the equity method has been appropriately applied.
- The timing of the auditor's appointment is such that the auditor is unable to observe the counting of the physical inventories.
- The auditor determines that performing substantive procedures alone is not sufficient, but the entity's controls are not effective.

A12. Examples of an inability to obtain sufficient appropriate audit evidence arising from a limitation on the scope of the audit imposed by management include when:

- Management prevents the auditor from observing the counting of the physical inventory.
- Management prevents the auditor from requesting external confirmation of specific account balances.

Determining the Type of Modification to the Auditor's Opinion

Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management-Imposed Limitation after the Auditor Has Accepted the Engagement (Ref: Para. 13(b)(i)–14)

A13. The practicality of withdrawing from the audit may depend on the stage of completion of the engagement at the time that management imposes the scope limitation. If the auditor has substantially completed the audit, the auditor may decide to complete the audit to the extent possible, disclaim an opinion and explain the scope limitation within the Basis for Disclaimer of Opinion section prior to withdrawing.

A14. In certain circumstances, withdrawal from the audit may not be possible if the auditor is required by law or regulation to continue the audit engagement. This may be the case for an auditor that is appointed to audit the financial statements of public sector entities. It may also be the case in jurisdictions where the auditor is appointed to audit the financial statements covering a specific period, or appointed for a specific period and is prohibited from withdrawing before the completion of the audit of those financial statements or before the end of that period, respectively. The auditor may also consider it necessary to include an Other Matter paragraph in the auditor's report.[8]

A15. When the auditor concludes that withdrawal from the audit is necessary because of a scope limitation, there may be a professional, legal or regulatory requirement for the auditor to communicate matters relating to the withdrawal from the engagement to regulators or the entity's owners.

Other Considerations Relating to an Adverse Opinion or Disclaimer of Opinion (Ref: Para. 15)

A16. The following are examples of reporting circumstances that would not contradict the auditor's adverse opinion or disclaimer of opinion:

- The expression of an unmodified opinion on financial statements prepared under a given financial reporting framework and, within the same report, the expression of an adverse opinion on the same financial statements under a different financial reporting framework.[9]

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8 HKSA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*, paragraph A10

9 See paragraph A31 of HKSA 700 (Revised) for a description of this circumstance.

- The expression of a disclaimer of opinion regarding the results of operations, and cash flows, where relevant, and an unmodified opinion regarding the financial position (see HKSA 510[10]). In this case, the auditor has not expressed a disclaimer of opinion on the financial statements as a whole.

Form and Content of the Auditor's Report When the Opinion Is Modified

Illustrative Auditor's Reports (Ref: Para. 16)

A17. Illustrations 1 and 2 in the Appendix contain auditor's reports with qualified and adverse opinions, respectively, as the financial statements are materially misstated.

A18. Illustration 3 in the Appendix contains an auditor's report with a qualified opinion as the auditor is unable to obtain sufficient appropriate audit evidence. Illustration 4 contains a disclaimer of opinion due to an inability to obtain sufficient appropriate audit evidence about a single element of the financial statements. Illustration 5 contains a disclaimer of opinion due to an inability to obtain sufficient appropriate audit evidence about multiple elements of the financial statements. In each of the latter two cases, the possible effects on the financial statements of the inability are both material and pervasive. The Appendices to other HKSAs that include reporting requirements, including HKSA 570 (Revised),[11] also include illustrations of auditor's reports with modified opinions.

Auditor's Opinion (Ref: Para. 16)

A19. Amending this heading makes it clear to the user that the auditor's opinion is modified and indicates the type of modification.

Qualified Opinion (Ref: Para. 17)

A20. When the auditor expresses a qualified opinion, it would not be appropriate to use phrases such as "with the foregoing explanation" or "subject to" in the Opinion section as these are not sufficiently clear or forceful.

Basis for Opinion (Ref: Para. 20, 21, 23, 27)

A21. Consistency in the auditor's report helps to promote users' understanding and to identify unusual circumstances when they occur. Accordingly, although uniformity in the wording of a modified opinion and in the description of the reasons for the modification may not be possible, consistency in both the form and content of the auditor's report is desirable.

A22. An example of the financial effects of material misstatements that the auditor may describe within the Basis for Opinion section in the auditor's report is the quantification of the effects on income tax, income before taxes, net income and equity if inventory is overstated.

A23. Disclosing the omitted information within the Basis for Opinion section would not be practicable if:

(a) The disclosures have not been prepared by management or the disclosures are otherwise not readily available to the auditor; or

(b) In the auditor's judgment, the disclosures would be unduly voluminous in relation to the auditor's report.

[10] HKSA 510, *Initial Audit Engagements—Opening Balances*, paragraph 10

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

A24. An adverse opinion or a disclaimer of opinion relating to a specific matter described within the Basis for Opinion section does not justify the omission of a description of other identified matters that would have otherwise required a modification of the auditor's opinion. In such cases, the disclosure of such other matters of which the auditor is aware may be relevant to users of the financial statements.

Description of Auditor's Responsibilities for the Audit of the Financial Statements When the Auditor Disclaims an Opinion on the Financial Statements (Ref: Para. 28)

A25. When the auditor disclaims an opinion on the financial statements, the following statements are better positioned within the Auditor's Responsibilities for the Audit of the Financial Statements section of the auditor's report, as illustrated in Illustrations 4–5 of the Appendix to this HKSA:

- The statement required by paragraph 28(a) of HKSA 700 (Revised), amended to state that the auditor's responsibility is to conduct an audit of the entity's financial statements in accordance with HKSAs; and
- The statement required by paragraph 28(c) of HKSA 700 (Revised) about independence and other ethical responsibilities.

Considerations When the Auditor Disclaims an Opinion on the Financial Statements (Ref: Para. 29)

A26. Providing the reasons for the auditor's inability to obtain sufficient appropriate audit evidence within the Basis for Disclaimer of Opinion section of the auditor's report provides useful information to users in understanding why the auditor has disclaimed an opinion on the financial statements and may further guard against inappropriate reliance on them. However, communication of any key audit matters other than the matter(s) giving rise to the disclaimer of opinion may suggest that the financial statements as a whole are more credible in relation to those matters than would be appropriate in the circumstances, and would be inconsistent with the disclaimer of opinion on the financial statements as a whole. Similarly, it would not be appropriate to include an Other Information section in accordance with HKSA 720 (Revised) addressing the auditor's consideration of the consistency of the other information with the financial statements. Accordingly, paragraph 29 of this HKSA prohibits a Key Audit Matters section or an Other Information section from being included in the auditor's report when the auditor disclaims an opinion on the financial statements, unless the auditor is otherwise required by law or regulation to communicate key audit matters or to report on other informaiton.

Communication with Those Charged with Governance (Ref: Para. 30)

A27. Communicating with those charged with governance the circumstances that lead to an expected modification to the auditor's opinion and the wording of the modification enables:

(a) The auditor to give notice to those charged with governance of the intended modification(s) and the reasons (or circumstances) for the modification(s);

(b) The auditor to seek the concurrence of those charged with governance regarding the facts of the matter(s) giving rise to the expected modification(s), or to confirm matters of disagreement with management as such; and

(c) Those charged with governance to have an opportunity, where appropriate, to provide the auditor with further information and explanations in respect of the matter(s) giving rise to the expected modification(s).

Appendix
(Ref: Para. A17–A18, A25)

Illustrations of Auditor's Reports with Modifications to the Opinion

- Illustration 1: An auditor's report containing a qualified opinion due to a material misstatement of the financial statements.
- Illustration 2: An auditor's report containing an adverse opinion due to a material misstatement of the consolidated financial statements.
- Illustration 3: An auditor's report containing a qualified opinion due to the auditor's inability to obtain sufficient appropriate audit evidence regarding a foreign associate.
- Illustration 4: An auditor's report containing a disclaimer of opinion due to the auditor's inability to obtain sufficient appropriate audit evidence about a single element of the consolidated financial statements.
- Illustration 5: An auditor's report containing a disclaimer of opinion due to the auditor's inability to obtain sufficient appropriate audit evidence about multiple elements of the financial statements.

Illustration 1 – Qualified Opinion due to a Material Misstatement of the Financial Statements

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of a listed entity using Hong Kong Financial Reporting Standards (HKFRSs). The audit is not a group audit (i.e., HKSA 600[1] does not apply).
- The financial statements are prepared by the directors of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of the directors' responsibility for the financial statements in HKSA 210.[2]
- Inventories are misstated. The misstatement is deemed to be material but not pervasive to the financial statements (i.e., a qualified opinion is appropriate).
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).
- Key audit matters have been communicated in accordance with HKSA 701.
- The auditor has obtained all of the other information prior to the date of the auditor's report and the matter giving rise to the qualified opinion on the consolidated financial statements also affects the other information.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company

(incorporated in Hong Kong with limited liability)[2a]

Report on the Audit of the Financial Statements[3]

Qualified Opinion

We have audited the financial statements of ABC Company ("the Company") set out on pages …… to ……, which comprise the statement of financial position as at 31 December 20X1, and [the statement of profit or loss and][3a] the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements,

[1] HKSA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

[2] HKSA 210, *Agreeing the Terms of Audit Engagements*

[2a] In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

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

[3a] HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.

including a summary of significant accounting policies.

In our opinion, except for the effects of the matter described in the *Basis for Qualified Opinion* section of our report, 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") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Qualified Opinion

The Company's inventories are carried in the statement of financial position at xxx. The directors have not stated the inventories at the lower of cost and net realizable value but have stated them solely at cost, which constitutes a departure from HKFRSs. The Company's records indicate that, had the directors stated the inventories at the lower of cost and net realizable value, an amount of xxx would have been required to write the inventories down to their net realizable value. Accordingly, cost of sales would have been increased by xxx, and income tax, net income and shareholders' equity would have been reduced by xxx, xxx and xxx, respectively.

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") 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"), and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

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 6 in Appendix 2 of HKSA 720 (Revised). The last paragraph of the other information section in Illustration 6 would be customized to describe the specific matter giving rise to the qualified opinion that also affects the other information.*]

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. In addition to the matter described in the *Basis for Qualified Opinion* section we have determined the matters described below to be the key audit matters to be communicated in our report.

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

Responsibilities of Directors and Those Charged with Governance for the Financial Statements[4]

[Reporting in accordance with HKSA 700 (Revised) – see Illustration 1 in HKSA 700 (Revised).]

Auditor's Responsibilities for the Audit of the Financial Statements

[Reporting in accordance with HKSA 700 (Revised) – see Illustration 1 in HKSA 700 (Revised).]

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4 Throughout the illustrative auditor's reports, the terms directors and those charged with governance may need to be replaced by another term that is appropriate in the context of the legal framework in the particular jurisdiction.

Report on Other Legal and Regulatory Requirements

[Reporting in accordance with HKSA 700 (Revised) – see Illustration 1 in HKSA 700 (Revised).]

The engagement partner on the audit resulting in this independent auditor's report is [*name*].

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[*Auditor Address*]

[*Date*]

Illustration 2 – Adverse Opinion due to a Material Misstatement of the Consolidated Financial Statements

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of consolidated financial statements of a listed entity using Hong Kong Financial Reporting Standards (HKFRSs). The audit is a group audit of an entity with subsidiaries (i.e., HKSA 600 applies).
- The consolidated financial statements are prepared by the directors of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of the directors' responsibility for the consolidated financial statements in HKSA 210.
- The consolidated financial statements are materially misstated due to the non-consolidation of a subsidiary. The material misstatement is deemed to be pervasive to the consolidated financial statements. The effects of the misstatement on the consolidated financial statements have not been determined because it was not practicable to do so (i.e., an adverse opinion is appropriate).
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).
- HKSA 701 applies; however, the auditor has determined that there are no key audit matters other than the matter described in the Basis for Adverse Opinion section.
- The auditor has obtained all of the other information prior to the date of the auditor's report and the matter giving rise to the adverse opinion on the consolidated financial statements also affects the other information.
- Those responsible for oversight of the consolidated financial statements differ from those responsible for the preparation of the consolidated financial statements.
- In addition to the audit of the consolidated financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance. Assume compliance with the Hong Kong Companies Ordinance on non-consolidation of a subsidiary.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company

(incorporated in Hong Kong with limited liability)[4a]

Report on the Audit of the Consolidated Financial Statements[5]

Adverse Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries ("the Group") set out on pages …… to ……, which comprise the consolidated statement of financial position as at 31

[4a] In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

[5] The sub-title "Report on the Audit of the Consolidated Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

December 20X1, and [the consolidated statement of profit or loss and][5a] the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, because of the significance of the matter discussed in the *Basis for Adverse Opinion* section of our report, the consolidated financial statements do not give a true and fair view of the consolidated financial position of the Group as at 31 December 20X1, and of its consolidated financial performance and its consolidated 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"). In all other respects, in our opinion the consolidated financial statements have been properly prepared in compliance with the Hong Kong Companies Ordinance.[5b]

Basis for Adverse Opinion

As explained in Note X, the Group has not consolidated subsidiary DEF Company that the Group acquired during 20X1 because it has not yet been able to determine the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This investment is therefore accounted for on a cost basis. Under HKFRSs, the Company should have consolidated this subsidiary and accounted for the acquisition based on provisional amounts. Had DEF Company been consolidated, many elements in the consolidated financial statements would have been materially affected. The effects on the consolidated financial statements of the failure to consolidate have not been determined.

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

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 7 in Appendix 2 of HKSA 720 (Revised). The last paragraph of the other information section in Illustration 7 would be customized to describe the specific matter giving rise to the qualified opinion that also affects the other information.*]

Key Audit Matters

Except for the matter described in the *Basis for Adverse Opinion* section, we have determined that there are no other key audit matters to communicate in our report.

[5a] HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.

[5b] Assume the consolidated financial statements have been properly prepared in accordance with the Hong Kong Companies Ordinance in all other respects.

Responsibilities of Directors and Those Charged with Governance for the Consolidated Financial Statements[6]

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 2 in HKSA 700 (Revised).*]

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 2 in HKSA 700 (Revised).*]

Report on Other Legal and Regulatory Requirements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 2 in HKSA 700 (Revised).*]

The engagement partner on the audit resulting in this independent auditor's report is [*name*].

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[Auditor Address]

[Date]

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[6] Or other terms that are appropriate in the context of the legal framework in the particular jurisdiction.

Illustration 3 – Qualified Opinion due to the Auditor's Inability to Obtain Sufficient Audit Evidence Regarding a Foreign Associate

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of consolidated financial statements of a listed entity using Hong Kong Financial Reporting Standards (HKFRSs). The audit is a group audit of an entity with subsidiaries (i.e., HKSA 600 applies).
- The consolidated financial statements are prepared by the directors of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of the directors' responsibility for the consolidated financial statements in HKSA 210.
- The auditor was unable to obtain sufficient appropriate audit evidence regarding an investment in a foreign associate. The possible effects of the inability to obtain sufficient appropriate audit evidence are deemed to be material but not pervasive to the consolidated financial statements (i.e., a qualified opinion is appropriate).
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).
- Key audit matters have been communicated in accordance with HKSA 701.
- The auditor has obtained all of the other information prior to the date of the auditor's report and the matter giving rise to the qualified opinion on the consolidated financial statements also affects the other information.
- Those responsible for oversight of the consolidated financial statements differ from those responsible for the preparation of the consolidated financial statements.
- In addition to the audit of the consolidated financial statements, the auditor has no other reporting responsibilities required under local law except for the Hong Kong Companies Ordinance.
- The information in the directors' report is not inconsistent with the consolidated financial statements.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company

(incorporated in Hong Kong with limited liability)[6a]

Report on the Audit of the Consolidated Financial Statements[7]

Qualified Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries ("the Group") set out on pages …… to ……, which comprise [the consolidated statement of profit or loss and][7a] the

[6a] In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

[7] Not used.

[7a] HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.

consolidated statement of financial position as at 31 December 20X1, and the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, except for the possible effects of the matter described in the *Basis for Qualified Opinion* section of our report, the consolidated financial statements give a true and fair view of the financial position of the Group as at 31 December, 20X1, and of its consolidated financial performance and its consolidated 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") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Qualified Opinion

The Group's investment in DEF Company, a foreign associate acquired during the year and accounted for by the equity method, is carried at xxx on the consolidated statement of financial position as at 31 December 20X1, and ABC's share of DEF's net income of xxx is included in ABC's income for the year then ended. We were unable to obtain sufficient appropriate audit evidence about the carrying amount of ABC's investment in DEF as at 31 December 20X1 and ABC's share of DEF's net income for the year because we were denied access to the financial information, management, and the auditors of DEF. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.

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

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 6 in Appendix 2 of HKSA 720 (Revised). The last paragraph of the other information section in Illustration 6 would be customized to describe the specific matter giving rise to the qualified opinion that also affects the other information.*]

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. In addition to the matter described in the *Basis for Qualified Opinion* section, we have determined the matters described below to be the key audit matters to be communicated in our report.

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

Responsibilities of Directors and Those Charged with Governance for the Consolidated Financial Statements[8]

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 2 in HKSA 700 (Revised).*]

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 2 in HKSA 700 (Revised).*]

Report on Other Matters under sections 407(2)[8a] and 407(3)[8a] of the Hong Kong Companies Ordinance[8b]

In respect alone of the inability to obtain sufficient appropriate audit evidence regarding an investment in a foreign associate as described in the *Basis for Qualified Opinion* section of our report above:

- we were unable to determine whether adequate accounting records had been kept; and
- we have not obtained all the information and explanations that, to the best of our knowledge and belief, are necessary and material for the purpose of the audit.

The engagement partner on the audit resulting in this independent auditor's report is [*name*].

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[*Auditor Address*]

[*Date*]

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8 Or other terms that are appropriate in the context of the legal framework in the particular jurisdiction

8a Section 407 of the CO requires the auditor to opine on other matters:

(1) In preparing an auditor's report, the auditor must carry out an investigation that will enable the auditor to form an opinion as to—
   (a) whether adequate accounting records have been kept by the company; and
   (b) whether the financial statements are in agreement with the accounting records.

(2) A company's auditor must state the auditor's opinion in the auditor's report if the auditor is of the opinion that—
   (a) adequate accounting records have not been kept by the company; or
   (b) the financial statements are not in agreement with the accounting records in any material respect.

(3) If a company's auditor fails to obtain all the information or explanations that, to the best of the auditor's knowledge and belief, are necessary and material for the purpose of the audit, the auditor must state that fact in the auditor's report.

(4) If the financial statements do not comply with section 383(1), the auditor must include in the auditor's report, so far as the auditor is reasonably able to do so, a statement giving the particulars that are required to be, but have not been, contained in the financial statements.

Where the opinion on the financial statements has been modified, the auditor needs to evaluate what the consequences of this modification are on the reporting requirement under the CO, and further modify the report if necessary.

8b For the requirements under the Hong Kong Companies Ordinance, reference may be made to PN 600.1 (Revised) *Reports by auditors under the Hong Kong Companies Ordinance*.

Illustration 4 – Disclaimer of Opinion due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence about a Single Element of the Consolidated Financial Statements

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of consolidated financial statements of an entity other than a listed entity using Hong Kong Financial Reporting Standards (HKFRSs). The audit is a group audit of an entity with subsidiaries (i.e., HKSA 600 applies).
- The consolidated financial statements are prepared by the directors of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of the directors' responsibility for the consolidated financial statements in HKSA 210.
- The auditor was unable to obtain sufficient appropriate audit evidence about a single element of the consolidated financial statements. That is, the auditor was also unable to obtain audit evidence about the financial information of a joint venture investment that represents over 90% of the entity's net assets. The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the consolidated financial statements (i.e., a disclaimer of opinion is appropriate).
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- The auditor has obtained all of the other information prior to the date of the auditor's report.
- Those responsible for oversight of the consolidated financial statements differ from those responsible for the preparation of the consolidated financial statements.
- A more limited description of the auditor's responsibilities section is required.
- In addition to the audit of the consolidated financial statements, the auditor has no other reporting responsibilities required under local law except for the Hong Kong Companies Ordinance.
- The information in the directors' report is not inconsistent with the consolidated financial statements.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company

(incorporated in Hong Kong with limited liability)[8c]

Report on the Audit of the Consolidated Financial Statements[9]

Disclaimer of Opinion

We were engaged to audit the consolidated financial statements of ABC Company and its subsidiaries ("the Group") set out on pages …… to ……, which comprise the consolidated statement of financial position as at 31 December 20X1, and [the consolidated statement of profit or loss and][9a] the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial

8c In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

9 Not used.

9a HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.

statements, including a summary of significant accounting policies.

We do not express an opinion on the consolidated financial statements of the Group. Because of the significance of the matter described in the *Basis for Disclaimer of Opinion* section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these consolidated financial statements. In all other respects, in our opinion the consolidated financial statements have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Disclaimer of Opinion

The Group's investment in its joint venture DEF Company is carried at xxx on the Group's consolidated statement of financial position, which represents over 90% of the Group's net assets as at 31 December 20X1. We were not allowed access to the management and the auditors of DEF Company, including DEF Company's auditors' audit documentation. As a result, we were unable to determine whether any adjustments were necessary in respect of the Group's proportional share of DEF Company's assets that it controls jointly, its proportional share of DEF Company's liabilities for which it is jointly responsible, its proportional share of DEF's income and expenses for the year, and the elements making up the consolidated statement of changes in equity and the consolidated cash flow statement.

Responsibilities of Directors and Those Charged with Governance for the Consolidated Financial Statements[10]

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 4 in HKSA 700 (Revised).]*

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our responsibility is to conduct an audit of the Group's consolidated financial statements in accordance with Hong Kong Standards on Auditing ("HKSAs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and to issue an auditor's report.[10a] However, because of the matter described in the *Basis for Disclaimer of Opinion* section of our report, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these consolidated financial statements.

We are independent of the Group in accordance with the HKICPA's *Code of Ethics for Professional Accountants* ("the Code"), and we have fulfilled our other ethical responsibilities in accordance with the Code.

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[10] Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction

[10a] Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditor's Duty of Care To Third Parties and The Audit Report".

Report on Other Matters under sections 407(2)[10b] and 407(3)[10b] of the Hong Kong

Companies Ordinance[10c]

In respect alone of the inability to obtain sufficient appropriate audit evidence regarding an investment in a joint venture as described in the *Basis for Disclaimer of Opinion* section of our report above:

- we were unable to determine whether adequate accounting records had been kept; and
- we have not obtained all the information and explanations that, to the best of our knowledge and belief, are necessary and material for the purpose of the audit.

XYZ & Co.

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

[*Date*]

[10b] Section 407 of the CO requires the auditor to opine on other matters:

(1) In preparing an auditor's report, the auditor must carry out an investigation that will enable the auditor to form an opinion as to—
 (a) whether adequate accounting records have been kept by the company; and
 (b) whether the financial statements are in agreement with the accounting records.

(2) A company's auditor must state the auditor's opinion in the auditor's report if the auditor is of the opinion that—
 (a) adequate accounting records have not been kept by the company; or
 (b) the financial statements are not in agreement with the accounting records in any material respect.

(3) If a company's auditor fails to obtain all the information or explanations that, to the best of the auditor's knowledge and belief, are necessary and material for the purpose of the audit, the auditor must state that fact in the auditor's report.

(4) If the financial statements do not comply with section 383(1), the auditor must include in the auditor's report, so far as the auditor is reasonably able to do so, a statement giving the particulars that are required to be, but have not been, contained in the financial statements.

Where the opinion on the financial statements has been modified, the auditor needs to evaluate what the consequences of this modification are on the reporting requirement under the CO, and further modify the report if necessary.

[10c] For the requirements under the Hong Kong Companies Ordinance, reference may be made to PN 600.1 (Revised) *Reports by auditors under the Hong Kong Companies Ordinance*.

Illustration 5 – Disclaimer of Opinion due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence about Multiple Elements of the Financial Statements

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of an entity other than a listed entity using Hong Kong Financial Reporting Standards (HKFRSs). The audit is not a group audit (i.e., HKSA 600, does not apply).
- The financial statements are prepared by the directors of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of the directors' responsibility for the financial statements in HKSA 210.
- The auditor was unable to obtain sufficient appropriate audit evidence about multiple elements of the financial statements, that is, the auditor was also unable to obtain audit evidence about the entity's inventories and accounts receivable. The possible effects of this inability to obtain sufficient appropriate audit evidence are deemed to be both material and pervasive to the financial statements.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- The auditor has obtained all of the other information prior to the date of the auditor's report.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- A more limited description of the auditor's responsibilities section is required.
- In addition to the audit of the financial statements, the auditor has no other reporting responsibilities required under local law except for the Hong Kong Companies Ordinance.
- The information in the directors' report is not inconsistent with the financial statements.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company

(incorporated in Hong Kong with limited liability)[10d]

Report on the Audit of the Financial Statements[11]

Disclaimer of Opinion

We were engaged to audit the financial statements of ABC Company ("the Company") set out on pages …… to ……, which comprise the statement of financial position as at 31 December 20X1, and [the statement of profit or loss and][11a] the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

[10d] In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

[11] Not used.

[11a] HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.

We do not express an opinion on the financial statements of the Company. Because of the significance of the matters described in the *Basis for Disclaimer of Opinion* section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements. In all other respects, in our opinion the financial statements have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Disclaimer of Opinion

We were not appointed as auditors of the Company until after 31 December 20X1 and thus did not observe the counting of physical inventories at the beginning and end of the year. We were unable to satisfy ourselves by alternative means concerning the inventory quantities held at 31 December 20X0 and 20X1, which are stated in the statements of financial position at xxx and xxx, respectively. In addition, the introduction of a new computerized accounts receivable system in September 20X1 resulted in numerous errors in accounts receivable. As of the date of our report, management was still in the process of rectifying the system deficiencies and correcting the errors. We were unable to confirm or verify by alternative means accounts receivable included in the statement of financial position at a total amount of xxx as at 31 December 20X1. As a result of these matters, we were unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded inventories and accounts receivable, and the elements making up [the statement of profit or loss and][11a] the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows.

Responsibilities of Directors and Those Charged with Governance for the Financial Statements[12]

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 3 in HKSA 700 (Revised).*]

Auditor's Responsibilities for the Audit of the Financial Statements

Our responsibility is to conduct an audit of the Company's financial statements in accordance with Hong Kong Standards on Auditing ("HKSAs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and to issue an auditor's report.[12a] However, because of the matters described in the *Basis for Disclaimer of Opinion* section of our report, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

We are independent of the Company in accordance with the HKICPA's *Code of Ethics for Professional Accountants* ("the Code"), and we have fulfilled our other ethical responsibilities in accordance with the Code.

[12] Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction

[12a] Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditor's Duty of Care To Third Parties and The Audit Report".

Report on Other Matters under sections 407(2)[12b] and 407(3)[12b] of the Hong Kong

Companies Ordinance[12c]

In respect alone of the inability to obtain sufficient appropriate audit evidence about the inventories and accounts receivable as described in the *Basis for Disclaimer of Opinion* section of our report above:

- we were unable to determine whether adequate accounting records had been kept; and
- we have not obtained all the information and explanations that, to the best of our knowledge and belief, are necessary and material for the purpose of the audit.

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[*Auditor Address*]

[*Date*]

[12b] Section 407 of the CO requires the auditor to opine on other matters:

(1) In preparing an auditor's report, the auditor must carry out an investigation that will enable the auditor to form an opinion as to—
  (a) whether adequate accounting records have been kept by the company; and
  (b) whether the financial statements are in agreement with the accounting records.

(2) A company's auditor must state the auditor's opinion in the auditor's report if the auditor is of the opinion that—
  (a) adequate accounting records have not been kept by the company; or
  (b) the financial statements are not in agreement with the accounting records in any material respect.

(3) If a company's auditor fails to obtain all the information or explanations that, to the best of the auditor's knowledge and belief, are necessary and material for the purpose of the audit, the auditor must state that fact in the auditor's report.

(4) If the financial statements do not comply with section 383(1), the auditor must include in the auditor's report, so far as the auditor is reasonably able to do so, a statement giving the particulars that are required to be, but have not been, contained in the financial statements.

Where the opinion on the financial statements has been modified, the auditor needs to evaluate what the consequences of this modification are on the reporting requirement under the CO, and further modify the report if necessary.

[12c] For the requirements under the Hong Kong Companies Ordinance, reference may be made to PN 600.1 (Revised) *Reports by auditors under the Hong Kong Companies Ordinance*.

HKSA 706 (Revised)

Issued August 2015

Effective for audits of financial statements

for periods ending on or after 15 December 2016

Hong Kong Standard on Auditing 706 (Revised)

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

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

HONG KONG STANDARD ON AUDITING 706 (REVISED) EMPHASIS OF MATTER PARAGRAPHS AND OTHER MATTER PARAGRAPHS IN THE INDEPENDENT AUDITOR'S REPORT

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

CONTENTS

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

Introduction

Scope of this HKSA

1. This Hong Kong Standard on Auditing (HKSA) deals with additional communication in the auditor's report when the auditor considers it necessary to:

    (a) Draw users' attention to a matter or matters presented or disclosed in the financial statements that are of such importance that they are fundamental to users' understanding of the financial statements; or

    (b) Draw users' attention to any matter or matters other than those presented or disclosed in the financial statements that are relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

2. HKSA 701[1] establishes requirements and provides guidance when the auditor determines key audit matters and communicates them in the auditor's report. When the auditor includes a Key Audit Matters section in the auditor's report, this HKSA addresses the relationship between key audit matters and any additional communication in the auditor's report in accordance with this HKSA. (Ref: Para. A1–A3)

3. HKSA 570 (Revised)[2] and HKSA 720 (Revised)[3] establish requirements and provide guidance about communication in the auditor's report relating to going concern and other information, respectively.

4. Appendices 1 and 2 identify HKSAs that contain specific requirements for the auditor to include Emphasis of Matter paragraphs or Other Matter paragraphs in the auditor's report. In those circumstances, the requirements in this HKSA regarding the form of such paragraphs apply. (Ref: Para. A4)

Effective Date

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

Objective

6. The objective of the auditor, having formed an opinion on the financial statements, is to draw users' attention, when in the auditor's judgment it is necessary to do so, by way of clear additional communication in the auditor's report, to:

    (a) A matter, although appropriately presented or disclosed in the financial statements, that is of such importance that it is fundamental to users' understanding of the financial statements; or

    (b) As appropriate, any other matter that is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

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

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

[3] HKSA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*

Definitions

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

   (a) Emphasis of Matter paragraph – A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

   (b) Other Matter paragraph – A paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

Requirements

Emphasis of Matter Paragraphs in the Auditor's Report

8. If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided: (Ref: Para. A5–A6)

   (a) The auditor would not be required to modify the opinion in accordance with HKSA 705 (Revised)[4] as a result of the matter; and

   (b) When HKSA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report. (Ref: Para. A1–A3)

9. When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall:

   (a) Include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term "Emphasis of Matter";

   (b) Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements. The paragraph shall refer only to information presented or disclosed in the financial statements; and

   (c) Indicate that the auditor's opinion is not modified in respect of the matter emphasized. (Ref: Para. A7–A8, A16–A17)

Other Matter Paragraphs in the Auditor's Report

10. If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report, the auditor shall include an Other Matter paragraph in the auditor's report, provided:

   (a) This is not prohibited by law or regulation; and

   (b) When HKSA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report. (Ref: Para. A9–A14)

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[4] HKSA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*

11. When the auditor includes an Other Matter paragraph in the auditor's report, the auditor shall include the paragraph within a separate section with the heading "Other Matter," or other appropriate heading. (Ref: Para. A15–A17)

Communication with Those Charged with Governance

12. If the auditor expects to include an Emphasis of Matter or an Other Matter paragraph in the auditor's report, the auditor shall communicate with those charged with governance regarding this expectation and the wording of this paragraph. (Ref: Para. A18)

Conformity and Compliance with International Standards on Auditing

13. As of August 2015 (date of issue), this HKSA conforms with International Standard on Auditing (ISA) 706 (Revised) *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*. Compliance with the requirements of this HKSA ensures compliance with ISA 706 (Revised).

14. Additional local explanation and guidance is provided in Appendices 3 and 4.

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Application and Other Explanatory Material

The Relationship between Emphasis of Matter Paragraphs and Key Audit Matters in the Auditor's Report (Ref: Para. 2, 8(b))

A1. Key audit matters are defined in HKSA 701 as 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, which include significant findings from the audit of the financial statements of the current period.[5] Communicating key audit matters provides additional information to intended users of the financial statements to assist them in understanding those matters that, in the auditor's professional judgment, were of most significance in the audit and may also assist them in understanding the entity and areas of significant management judgment in the audited financial statements. When HKSA 701 applies, the use of Emphasis of Matter paragraphs is not a substitute for a description of individual key audit matters.

A2. Matters that are determined to be key audit matters in accordance with HKSA 701 may also be, in the auditor's judgment, fundamental to users' understanding of the financial statements. In such cases, in communicating the matter as a key audit matter in accordance with HKSA 701, the auditor may wish to highlight or draw further attention to its relative importance. The auditor may do so by presenting the matter more prominently than other matters in the Key Audit Matters section (e.g., as the first matter) or by including additional information in the description of the key audit matter to indicate the importance of the matter to users' understanding of the financial statements.

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5 HKSA 260 (Revised), *Communication with Those Charged with Governance*, paragraph 16

A3. There may be a matter that is not determined to be a key audit matter in accordance with HKSA 701 (i.e., because it did not require significant auditor attention), but which, in the auditor's judgment, is fundamental to users' understanding of the financial statements (e.g., a subsequent event). If the auditor considers it necessary to draw users' attention to such a matter, the matter is included in an Emphasis of Matter paragraph in the auditor's report in accordance with this HKSA.

Circumstances in Which an Emphasis of Matter Paragraph May Be Necessary (Ref: Para. 4, 8)

A4. Appendix 1 identifies HKSAs that contain specific requirements for the auditor to include Emphasis of Matter paragraphs in the auditor's report in certain circumstances. These circumstances include:

- When a financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation.
- To alert users that the financial statements are prepared in accordance with a special purpose framework.
- When facts become known to the auditor after the date of the auditor's report and the auditor provides a new or amended auditor's report (i.e., subsequent events).[6]

A5. Examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are:

- An uncertainty relating to the future outcome of exceptional litigation or regulatory action.
- A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report.[7]
- Early application (where permitted) of a new accounting standard that has a material effect on the financial statements.
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

A6. However, a widespread use of Emphasis of Matter paragraphs may diminish the effectiveness of the auditor's communication about such matters.

Including an Emphasis of Matter Paragraph in the Auditor's Report (Ref: Para. 9)

A7. The inclusion of an Emphasis of Matter paragraph in the auditor's report does not affect the auditor's opinion. An Emphasis of Matter paragraph is not a substitute for:

(a) A modified opinion in accordance with HKSA 705 (Revised) when required by the circumstances of a specific audit engagement;

(b) Disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation; or

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6 HKSA 560, *Subsequent Events*, paragraphs 12(b) and 16

7 HKSA 560, paragraph 6

(c) Reporting in accordance with HKSA 570 (Revised)[8] when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern.

A8. Paragraphs A16–A17 provide further guidance on the placement of Emphasis of Matter paragraphs in particular circumstances.

Other Matter Paragraphs in the Auditor's Report (Ref: Para. 10–11)

Circumstances in Which an Other Matter Paragraph May Be Necessary

Relevant to Users' Understanding of the Audit

A9. HKSA 260 (Revised) requires the auditor to communicate with those charged with governance about the planned scope and timing of the audit, which includes communication about the significant risks identified by the auditor.[9] Although matters relating to significant risks may be determined to be key audit matters, other planning and scoping matters (e.g., the planned scope of the audit, or the application of materiality in the context of the audit) are unlikely to be key audit matters because of how key audit matters are defined in HKSA 701. However, law or regulation may require the auditor to communicate about planning and scoping matters in the auditor's report, or the auditor may consider it necessary to communicate about such matters in an Other Matter paragraph.

A10. In the rare circumstance where the auditor is unable to withdraw from an engagement even though the possible effect of an inability to obtain sufficient appropriate audit evidence due to a limitation on the scope of the audit imposed by management is pervasive,[10] the auditor may consider it necessary to include an Other Matter paragraph in the auditor's report to explain why it is not possible for the auditor to withdraw from the engagement.

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

A11. Law, regulation or generally accepted practice in a jurisdiction may require or permit the auditor to elaborate on matters that provide further explanation of the auditor's responsibilities in the audit of the financial statements or of the auditor's report thereon. When the Other Matter section includes more than one matter that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report, it may be helpful to use different sub-headings for each matter.

A12. An Other Matter paragraph does not deal with circumstances where the auditor has other reporting responsibilities that are in addition to the auditor's responsibility under the HKSAs (see Other Reporting Responsibilities section in HKSA 700 (Revised)[11]), or where the auditor has been asked to perform and report on additional specified procedures, or to express an opinion on specific matters.

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[8] HKSA 570 (Revised), paragraphs 22–23

[9] HKSA 260 (Revised), paragraph 15

[10] See paragraph 13(b)(ii) of HKSA 705 (Revised) for a discussion of this circumstance.

[11] HKSA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, paragraphs 42–44

Reporting on more than one set of financial statements

A13. An entity may prepare one set of financial statements in accordance with a general purpose framework (e.g., Hong Kong Financial Reporting Standards) and another set of financial statements in accordance with another general purpose framework (e.g., International Financial Reporting Standards), and engage the auditor to report on both sets of financial statements. If the auditor has determined that the frameworks are acceptable in the respective circumstances, the auditor may include an Other Matter paragraph in the auditor's report, referring to the fact that another set of financial statements has been prepared by the same entity in accordance with another general purpose framework and that the auditor has issued a report on those financial statements.

Restriction on distribution or use of the auditor's report

A14. Financial statements prepared for a specific purpose may be prepared in accordance with a general purpose framework because the intended users have determined that such general purpose financial statements meet their financial information needs. Since the auditor's report is intended for specific users, the auditor may consider it necessary in the circumstances to include an Other Matter paragraph, stating that the auditor's report is intended solely for the intended users, and should not be distributed to or used by other parties.

Including an Other Matter Paragraph in the Auditor's Report

A15. The content of an Other Matter paragraph reflects clearly that such other matter is not required to be presented and disclosed in the financial statements. An Other Matter paragraph does not include information that the auditor is prohibited from providing by law, regulation or other professional standards, for example, ethical standards relating to confidentiality of information. An Other Matter paragraph also does not include information that is required to be provided by management.

Placement of Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Auditor's Report (Ref: Para. 9, 11)

A16. The placement of an Emphasis of Matter paragraph or Other Matter paragraph in the auditor's report depends on the nature of the information to be communicated, and the auditor's judgment as to the relative significance of such information to intended users compared to other elements required to be reported in accordance with HKSA 700 (Revised). For example:

Emphasis of Matter Paragraphs

- When the Emphasis of Matter paragraph relates to the applicable financial reporting framework, including circumstances where the auditor determines that the financial reporting framework prescribed by law or regulation would otherwise be unacceptable,[12] the auditor may consider it necessary to place the paragraph immediately following the Basis of Opinion section to provide appropriate context to the auditor's opinion.
- When a Key Audit Matters section is presented in the auditor's report, an Emphasis of Matter paragraph may be presented either directly before or after the Key Audit Matters section, based on the auditor's judgment as to the relative significance of the information

[12] For example, as required by HKSA 210, *Agreeing the Terms of Audit Engagements*, paragraph 19 and HKSA 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks*, paragraph 14

included in the Emphasis of Matter paragraph. The auditor may also add further context to the heading "Emphasis of Matter", such as "Emphasis of Matter – Subsequent Event", to differentiate the Emphasis of Matter paragraph from the individual matters described in the Key Audit Matters section.

Other Matter Paragraphs

- When a Key Audit Matters section is presented in the auditor's report and an Other Matter paragraph is also considered necessary, the auditor may add further context to the heading "Other Matter", such as "Other Matter – Scope of the Audit", to differentiate the Other Matter paragraph from the individual matters described in the Key Audit Matters section.
- When an Other Matter paragraph is included to draw users' attention to a matter relating to Other Reporting Responsibilities addressed in the auditor's report, the paragraph may be included in the Report on Other Legal and Regulatory Requirements section.
- When relevant to all the auditor's responsibilities or users' understanding of the auditor's report, the Other Matter paragraph may be included as a separate section following the Report on the Audit of the Financial Statements and the Report on Other Legal and Regulatory Requirements.

A17. Appendix 3 is an illustration of the interaction between the Key Audit Matters section, an Emphasis of Matter paragraph and an Other Matter paragraph when all are presented in the auditor's report. The illustrative report in Appendix 4 includes an Emphasis of Matter paragraph in an auditor's report for an entity other than a listed entity that contains a qualified opinion and for which key audit matters have not been communicated.

Communication with Those Charged with Governance (Ref. Para. 12)

A18. The communication required by paragraph 12 enables those charged with governance to be made aware of the nature of any specific matters that the auditor intends to highlight in the auditor's report, and provides them with an opportunity to obtain further clarification from the auditor where necessary. Where the inclusion of an Other Matter paragraph on a particular matter in the auditor's report recurs on each successive engagement, the auditor may determine that it is unnecessary to repeat the communication on each engagement, unless otherwise required to do so by law or regulation.

Appendix 1

(Ref: Para. 4, A4)

List of HKSAs Containing Requirements for Emphasis of Matter Paragraphs

This appendix identifies paragraphs in other HKSAs that require the auditor to include an Emphasis of Matter paragraph in the auditor's report in certain circumstances. The list is not a substitute for considering the requirements and related application and other explanatory material in HKSAs.

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

Appendix 2

(Ref: Para. 4)

List of HKSAs Containing Requirements for Other Matter Paragraphs

This appendix identifies paragraphs in other HKSAs that require the auditor to include an Other Matter paragraph in the auditor's report in certain circumstances. The list is not a substitute for considering the requirements and related application and other explanatory material in HKSAs.

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

Appendix 3

(Ref: Para. A17)

Illustration of an Auditor's Report that Includes a Key Audit Matters Section, an Emphasis of Matter Paragraph, and an Other Matter Paragraph

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of a listed entity using Hong Kong Financial Reporting Standards (HKFRSs). The audit is not a group audit (i.e., HKSA 600[1] does not apply).
- The financial statements are prepared by the directors of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of the directors' responsibility for the financial statements in HKSA 210.
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).
- Between the date of the financial statements and the date of the auditor's report, there was a fire in the entity's production facilities, which was disclosed by the entity as a subsequent event. In the auditor's judgment, the matter is of such importance that it is fundamental to users' understanding of the financial statements. The matter did not require significant auditor attention in the audit of the financial statements in the current period.
- Key audit matters have been communicated in accordance with HKSA 701.
- The auditor has obtained all of the other information prior to the date of the auditor's report and has not identified a material misstatement of the other information.
- Corresponding figures are presented, and the prior period's financial statements were audited by a predecessor auditor. The auditor is not prohibited by law or regulation from referring to the predecessor auditor's report on the corresponding figures and has decided to do so.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company

(incorporated in Hong Kong with limited liability)[1a]

[1] HKSA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

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

Report on the Audit of the Financial Statements[2]

Opinion

We have audited the financial statements of ABC Company ("the Company") set out on pages …… to ……, which comprise the statement of financial position as at 31 December 20X1, and [the statement of profit or loss and][2a] the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

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") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") 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"), and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of Matter[3]

We draw attention to Note X of the financial statements, which describes the effects of a fire in the Company's production facilities. Our opinion is not modified in respect of this matter.

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.*]

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

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

[3] As noted in paragraph A16, an Emphasis of Matter paragraph may be presented either directly before or after the Key Audit Matters section based on the auditor's judgment as to the relative significance of the information included in the Emphasis of Matter paragraph.

Other Matter

The financial statements of ABC Company for the year ended 31 December 20X0, were audited by another auditor who expressed an unmodified opinion on those statements on 31 March 20X1.

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 Statements[4]

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 1 in HKSA 700 (Revised).*]

Auditor's Responsibilities for the Audit of the Financial Statements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 1 in HKSA 700 (Revised).*]

Report on Other Legal and Regulatory Requirements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 1 in HKSA 700 (Revised).*]

The engagement partner on the audit resulting in this independent auditor's report is [*name*].

XYZ & Co.

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

[*Date*]

[4] Throughout these illustrative auditor's reports, the terms directors and those charged with governance may need to be replaced by another term that is appropriate in the context of the legal framework in the particular jurisdiction.

Appendix 4

(Ref: Para. A8)

Illustration of an Auditor's Report Containing a Qualified Opinion Due to a Departure from the Applicable Financial Reporting Framework and that Includes an Emphasis of Matter Paragraph

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of an entity other than a listed entity using Hong Kong Financial Reporting Standards (HKFRSs). The audit is not a group audit (i.e., HKSA 600 does not apply).
- The financial statements are prepared by the directors of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of the directors responsibility for the financial statements in HKSA 210.
- A departure from the applicable financial reporting framework resulted in a qualified opinion.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).
- Between the date of the financial statements and the date of the auditor's report, there was a fire in the entity's production facilities, which was disclosed by the entity as a subsequent event. In the auditor's judgment, the matter is of such importance that it is fundamental to users' understanding of the financial statements. The matter did not require significant auditor attention in the audit of the financial statements in the current period.
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with HKSA 701.
- The auditor has not obtained any other information prior to the date of the auditor's report.[4a]
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company

(incorporated in Hong Kong with limited liability)[4b]

[4a] Normally for an entity incorporated in Hong Kong, the auditor should have obtained the directors' report prior to the date of the auditor's report. Under section 406(2) of the Hong Kong Companies Ordinance, the auditor is required to state in the auditor's report if the auditor is of the opinion that the information in a directors' report is not consistent with the financial statements. The auditor should refer to HKSA 720 (Revised) for guidance.

[4b] In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

Report on the Audit of the Financial Statements[5]

Qualified Opinion

We have audited the financial statements of ABC Company ("the Company") set out on pages …… to ……, which comprise the statement of financial position as at 31 December 20X1, and [the statement of profit or loss and][5a] the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, except for the effects of the matter described in the *Basis for Qualified Opinion* section of our report, 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") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Qualified Opinion

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

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") 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"), and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

Emphasis of Matter – Effects of a Fire

We draw attention to Note X of the financial statements, which describes the effects of a fire in the Company's production facilities. Our opinion is not modified in respect of this matter.

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

[5a] HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.

Responsibilities of Directors and Those Charged with Governance for the Financial Statements[6]

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 3 in HKSA 700 (Revised).*]

Auditor's Responsibilities for the Audit of the Financial Statements

[*Reporting in accordance with HKSA 700 (Revised – see Illustration 3 in HKSA 700 (Revised).*]

Report on Other Legal and Regulatory Requirements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 3 in HKSA 700 (Revised).*]

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[*Auditor Address*]

[*Date*]

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

HKSA 710

Issued September 2009; revised July 2010,

June 2014*, August 2015**

Effective for audits of financial statements

for periods beginning on or after 15 December 2009

Hong Kong Standard on Auditing 710

Comparative Information—Corresponding Figures and Comparative Financial Statements

** Conforming amendments have been made to this HKSA as a result of the new and revised HKSAs issued in Update 172, and will become effective for audits of financial statements for periods ending on or after 15 December 2016. The conforming amendments are underlined for easy reference.

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

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

HONG KONG STANDARD ON AUDITING 710

COMPARATIVE INFORMATION—
CORRESPONDING FIGURES AND COMPARATIVE FINANCIAL STATEMENTS

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

CONTENTS

Hong Kong Standard on Auditing (HKSA) 710, "Comparative Information—Corresponding Figures and Comparative Financial Statements" should be read in conjunction with HKSA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing."

Introduction

Scope of this HKSA

1. This Hong Kong Standard on Auditing (HKSA) deals with the auditor's responsibilities relating to comparative information in an audit of financial statements. When the financial statements of the prior period have been audited by a predecessor auditor or were not audited, the requirements and guidance in HKSA 510[1] regarding opening balances also apply.

The Nature of Comparative Information

2. The nature of the comparative information that is presented in an entity's financial statements depends on the requirements of the applicable financial reporting framework. There are two different broad approaches to the auditor's reporting responsibilities in respect of such comparative information: corresponding figures and comparative financial statements. The approach to be adopted is often specified by law or regulation but may also be specified in the terms of engagement.

3. The essential audit reporting differences between the approaches are:

   (a) For corresponding figures [1a], the auditor's opinion on the financial statements refers to the current period only; whereas

   (b) For comparative financial statements, the auditor's opinion refers to each period for which financial statements are presented.

   This HKSA addresses separately the auditor's reporting requirements for each approach.

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 obtain sufficient appropriate audit evidence about whether the comparative information included in the financial statements has been presented, in all material respects, in accordance with the requirements for comparative information in the applicable financial reporting framework; and

   (b) To report in accordance with the auditor's reporting responsibilities.

Definitions

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

   (a) Comparative information – The amounts and disclosures included in the financial statements in respect of one or more prior periods in accordance with the applicable financial reporting framework.

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[1] HKSA 510, "Initial Audit Engagements—Opening Balances."

[1a] Additional local guidance is provided in Appendix 2.

(b) Corresponding figures – Comparative information where amounts and other disclosures for the prior period are included as an integral part of the current period financial statements, and are intended to be read only in relation to the amounts and other disclosures relating to the current period (referred to as "current period figures"). The level of detail presented in the corresponding amounts and disclosures is dictated primarily by its relevance to the current period figures.

(c) Comparative financial statements – Comparative information where amounts and other disclosures for the prior period are included for comparison with the financial statements of the current period but, if audited, are referred to in the auditor's opinion. The level of information included in those comparative financial statements is comparable with that of the financial statements of the current period.

For purposes of this HKSA, references to "prior period" should be read as "prior periods" when the comparative information includes amounts and disclosures for more than one period.

Requirements

Audit Procedures

7. The auditor shall determine whether the financial statements include the comparative information required by the applicable financial reporting framework and whether such information is appropriately classified. For this purpose, the auditor shall evaluate whether:

   (a) The comparative information agrees with the amounts and other disclosures presented in the prior period or, when appropriate, have been restated; and

   (b) The accounting policies reflected in the comparative information are consistent with those applied in the current period or, if there have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed.

8. If the auditor becomes aware of a possible material misstatement in the comparative information while performing the current period audit, the auditor shall perform such additional audit procedures as are necessary in the circumstances to obtain sufficient appropriate audit evidence to determine whether a material misstatement exists. If the auditor had audited the prior period's financial statements, the auditor shall also follow the relevant requirements of HKSA 560.[2] If the prior period financial statements are amended, the auditor shall determine that the comparative information agrees with the amended financial statements.

9. As required by HKSA 580,[3] the auditor shall request written representations for all periods referred to in the auditor's opinion. The auditor shall also obtain a specific written representation regarding any restatement made to correct a material misstatement in prior period financial statements that affect the comparative information. (Ref: Para. A1)

Audit Reporting

Corresponding Figures

10. When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures except in the circumstances described in paragraphs 11, 12, and 14. (Ref: Para. A2)

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[2] HKSA 560, "Subsequent Events," paragraphs 14-17.

[3] HKSA 580, "Written Representations," paragraph 14.

11. If the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modification is unresolved, the auditor shall modify the auditor's opinion on the current period's financial statements. In the Basis for Modification paragraph in the auditor's report, the auditor shall either:

    (a) Refer to both the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material; or

    (b) In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures. (Ref: Para. A3-A5)

12. If the auditor obtains audit evidence that a material misstatement exists in the prior period financial statements on which an unmodified opinion has been previously issued, and the corresponding figures have not been properly restated or appropriate disclosures have not been made, the auditor shall express a qualified opinion or an adverse opinion in the auditor's report on the current period financial statements, modified with respect to the corresponding figures included therein. (Ref: Para. A6)

Prior Period Financial Statements Audited by a Predecessor Auditor

13. If the financial statements of the prior period were audited by a predecessor auditor and the auditor is not prohibited by law or regulation from referring to the predecessor auditor's report on the corresponding figures and decides to do so, the auditor shall state in an Other Matter paragraph in the auditor's report:

    (a) That the financial statements of the prior period were audited by the predecessor auditor;

    (b) The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefore; and

    (c) The date of that report. (Ref: Para. A7)

Prior Period Financial Statements Not Audited

14. If the prior period financial statements were not audited, the auditor shall state in an Other Matter paragraph in the auditor's report that the corresponding figures are unaudited. Such a statement does not, however, relieve the auditor of the requirement to obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements.[4] (Ref: Para. A7a)

Comparative Financial Statements

15. When comparative financial statements are presented, the auditor's opinion shall refer to each period for which financial statements are presented and on which an audit opinion is expressed. (Ref: Para. A8-A9)

[4] HKSA 510, paragraph 6.

16. When reporting on prior period financial statements in connection with the current period's audit, if the auditor's opinion on such prior period financial statements differs from the opinion the auditor previously expressed, the auditor shall disclose the substantive reasons for the different opinion in an Other Matter paragraph in accordance with HKSA 706 (Revised).[5] (Ref: Para. A10)

Prior Period Financial Statements Audited by a Predecessor Auditor

17. If the financial statements of the prior period were audited by a predecessor auditor, in addition to expressing an opinion on the current period's financial statements, the auditor shall state in an Other Matter paragraph:

    (a) that the financial statements of the prior period were audited by a predecessor auditor;

    (b) the type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefore; and

    (c) the date of that report,

    unless the predecessor auditor's report on the prior period's financial statements is reissued with the financial statements.

18. If the auditor concludes that a material misstatement exists that affects the prior period financial statements on which the predecessor auditor had previously reported without modification, the auditor shall communicate the misstatement with the appropriate level of management and, unless all of those charged with governance are involved in managing the entity,[6] those charged with governance and request that the predecessor auditor be informed. If the prior period financial statements are amended, and the predecessor auditor agrees to issue a new auditor's report on the amended financial statements of the prior period, the auditor shall report only on the current period. (Ref: Para. A11)

Prior Period Financial Statements Not Audited

19. If the prior period financial statements were not audited, the auditor shall state in an Other Matter paragraph that the comparative financial statements are unaudited. Such a statement does not, however, relieve the auditor of the requirement to obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements.[7] (Ref: Para. A12)

Conformity and Compliance with International Standards on Auditing

20. As of September 2009 (date of issue), this HKSA conforms with International Standard on Auditing (ISA) 710 "Comparative Information Corresponding Figures and Comparative Financial Statements". Compliance with the requirements of this HKSA ensures compliance with ISA 710.

21. Additional local guidance is provided in footnote 1a and Appendices 1 and 2.

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[5] HKSA 706 (Revised), "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report," paragraph 8.

[6] HKSA 260, "Communication with Those Charged with Governance," paragraph 13.

[7] HKSA 510, paragraph 6.

Application and Other Explanatory Material

Audit Procedures

Written Representations (Ref: Para. 9)

A1. In the case of comparative financial statements, the written representations are requested for all periods referred to in the auditor's opinion because management needs to reaffirm that the written representations it previously made with respect to the prior period remain appropriate. In the case of corresponding figures, the written representations are requested for the financial statements of the current period only because the auditor's opinion is on those financial statements, which include the corresponding figures. However, the auditor requests a specific written representation regarding any restatement made to correct a material misstatement in the prior period financial statements that affect the comparative information.

Audit Reporting

Corresponding Figures

No Reference in Auditor's Opinion (Ref: Para. 10)

A2. The auditor's opinion does not refer to the corresponding figures because the auditor's opinion is on the current period financial statements as a whole, including the corresponding figures.

Modification in Auditor's Report on the Prior Period Unresolved (Ref: Para. 11)

A3. When the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modified opinion is resolved and properly accounted for or disclosed in the financial statements in accordance with the applicable financial reporting framework, the auditor's opinion on the current period need not refer to the previous modification.

A4. When the auditor's opinion on the prior period, as previously expressed, was modified, the unresolved matter that gave rise to the modification may not be relevant to the current period figures. Nevertheless, a qualified opinion, a disclaimer of opinion, or an adverse opinion (as applicable) may be required on the current period's financial statements because of the effects or possible effects of the unresolved matter on the comparability of the current and corresponding figures.

A5. Illustrative examples of the auditor's report if the auditor's report on the prior period included a modified opinion and the matter giving rise to the modification is unresolved are contained in Illustrations 1 and 2 of the Appendix.

Misstatement in Prior Period Financial Statements (Ref: Para. 12)

A6. When the prior period financial statements that are misstated have not been amended and an auditor's report has not been reissued, but the corresponding figures have been properly restated or appropriate disclosures have been made in the current period financial statements, the auditor's report may include an Emphasis of Matter paragraph describing the circumstances and referring to where relevant disclosures that fully describe the matter can be found in the financial statements (see HKSA 706).

Prior Period Financial Statements Audited by a Predecessor Auditor (Ref: Para. 13)

A7. An illustrative example of the auditor's report if the prior period financial statements were audited by a predecessor auditor and the auditor is not prohibited by law or regulation from referring to the predecessor auditor's report on the corresponding figures is contained in Illustration 3 of the Appendix.

Prior Period Financial Statements Not Audited (Ref: Para. 14)

A7a. If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor is required by HKSA 705 (Revised)[8] to express a qualified opinion or disclaim an opinion on the financial statements, as appropriate, in accordance with HKSA 705 (Revised). If the auditor encountered significant difficulty in obtaining sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements, the auditor may determine this to be a key audit matter in accordance with HKSA 701.[9]

Comparative Financial Statements

Reference in Auditor's Opinion (Ref: Para. 15)

A8. Because the auditor's report on comparative financial statements applies to the financial statements for each of the periods presented, the auditor may express a qualified opinion or an adverse opinion, disclaim an opinion, or include an Emphasis of Matter paragraph with respect to one or more periods, while expressing a different auditor's opinion on the financial statements of the other period.

A9. An illustrative example of the auditor's report if the auditor is required to report on both the current and the prior period financial statements in connection with the current year's audit and the prior period included a modified opinion and the matter giving rise to the modification is unresolved, is contained in Illustration 4 of the Appendix.

Opinion on Prior Period Financial Statements Different from Previous Opinion (Ref: Para. 16)

A10. When reporting on the prior period financial statements in connection with the current period's audit, the opinion expressed on the prior period financial statements may be different from the opinion previously expressed if the auditor becomes aware of circumstances or events that materially affect the financial statements of a prior period during the course of the audit of the current period. In some jurisdictions, the auditor may have additional reporting responsibilities designed to prevent future reliance on the auditor's previously issued report on the prior period financial statements.

Prior Period Financial Statements Audited by a Predecessor Auditor (Ref: Para. 18)

A11. The predecessor auditor may be unable or unwilling to reissue the auditor's report on the prior period financial statements. An Other Matter paragraph of the auditor's report may indicate that the predecessor auditor reported on the financial statements of the prior period before amendment. In addition, if the auditor is engaged to audit and obtains sufficient appropriate audit evidence to be satisfied as to the appropriateness of the amendment, the auditor's report may also include the following paragraph:

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[8] HKSA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*

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

As part of our audit of the 20X2 financial statements, we also audited the adjustments described in Note X that were applied to amend the 20X1 financial statements. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the 20X1 financial statements of the company other than with respect to the adjustments and, accordingly, we do not express an opinion or any other form of assurance on the 20X1 financial statements taken as a whole.

Prior Period Financial Statements Not Audited (Ref: Para. 19)

A12. If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor is required by HKSA 705 (Revised) to express a qualified opinion or disclaim an opinion on the financial statements, as appropriate, in accordance with HKSA 705 (Revised). If the auditor encountered significant difficulty in obtaining sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements, the auditor may determine this to be a key audit matter in accordance with HKSA 701.

Appendix 1

Illustrations of Auditors' Reports

Illustration 1 - Corresponding Figures (Ref: Para. A5)

For purposes of this ~~Report~~ illustrative auditor's report, the following ~~of the~~ circumstances ~~described in paragraph 11(a), as follows~~are assumed:

- Audit of a complete set of financial statements of an entity other than a listed entity using Hong Kong Financial Reporting Standards (HKFRSs). The audit is not a group audit (i.e., HKSA 600[1] does not apply).
- The financial statements are prepared by the directors of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of the directors' responsibility for the financial statements in HKSA 210.[2]
- The auditor's report on the prior period, as previously issued, included a qualified opinion.
- The matter giving rise to the modification is unresolved.
- The effects or possible effects of the matter on the current period's figures are material and require a modification to the auditor's opinion regarding the current period figures.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).[3]
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with HKSA 701.[4]
- The auditor has not obtained any other information prior to the date of the auditor's report.[4a]
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance.

INDEPENDENT AUDITOR'S REPORT

[1] HKSA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

[2] HKSA 210, *Agreeing the Terms of Audit Engagements*

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

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

[4a] Under section 406(2) of the Hong Kong Companies Ordinance, the auditor is required to state in the auditor's report if the auditor is of the opinion that the information in a directors' report is not consistent with the financial statements. In this regard, the auditor refers to HKSA 720 (Revised) for guidance.

~~TO THE MEMBERS OF ABC LIMITED~~To the Members of ABC Company

(incorporated in Hong Kong with limited liability)[~~1a~~4b]

~~[~~Report on the Audit of the Financial Statements~~]~~[~~1~~5]

Qualified Opinion

We have audited the financial statements of ABC ~~Limited~~ Company ("the Company") set out on pages …… to ……, which comprise the statement of financial position as at 31 December 20X1, and [the statement of profit or loss and][~~1b~~5a] the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies ~~and other explanatory information~~.

In our opinion, except for the effects of the matter described in the *Basis for Qualified Opinion* section of our report, 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") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Qualified Opinion

As discussed in Note X to the financial statements, no depreciation has been provided in the financial statements, which constitutes a departure from HKFRSs. This is the result of a decision taken by the directors at the start of the preceding financial year and caused us to qualify our audit opinion on the financial statements relating to that year. Based on the straight-line method of depreciation and annual rates of 5% for the building and 20% for the equipment, the loss for the year should be increased by xxx in 20X1 and xxx in 20X0, property, plant and equipment should be reduced by accumulated depreciation of xxx in 20X1 and xxx in 20X0, and the accumulated loss should be increased by xxx in 20X1 and xxx in 20X0.

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") 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"), and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

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

4b In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

~~1 The sub-title "Report on the~~ Audit of the ~~Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.~~

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

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

5a HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.

Responsibilities of Directors[~~2~~] and Those Charged with Governance for the Financial Statements[~~2~~6] ~~Responsibility for the Financial Statements~~

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 3 in HKSA 700 (Revised*).]

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

Auditor's Responsibility~~y~~ies for the Audit of the Financial Statements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 3 in HKSA 700 (Revised*).]

~~Our responsibility is to express an opinion on these financial statements based on our audit[3a]. We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.~~

~~An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.[5] An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.~~

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

~~*Basis for Qualified Opinion*~~

~~As discussed in Note X to the financial statements, no depreciation has been provided in the financial statements, which constitutes a departure from Hong Kong Financial Reporting Standards. This is the result of a decision taken by the directors at the start of the preceding financial year and caused us to qualify our audit opinion on the financial statements relating to that year. Based on the straight-line method of depreciation and annual rates of 5% for the building and 20% for the equipment, the loss for the year should be increased by xxx in 20X1 and xxx in 20X0, property, plant and equipment should be reduced by accumulated depreciation of xxx in 20X1 and xxx in 20X0, and the accumulated loss should be increased by xxx in 20X1 and xxx in 20X0.~~

~~2 Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.~~

6 Throughout these illustrative auditor's reports, the terms directors and those charged with governance may need to be replaced by another term that is appropriate in the context of the legal framework in the particular jurisdiction.

~~3 Not used.~~

~~3a Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".~~

~~4 Not used.~~

~~5 In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances."~~

~~*Qualified Opinion*~~

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

~~[~~Report on Other Legal and Regulatory Requirements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 3 in HKSA 700 (Revised*).]

~~[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]]~~~~[1]~~

XYZ & Co.

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

[*Auditor's ~~a~~Address*]

[*Date*] ~~of the auditor's report~~

Illustration 2 - Corresponding Figures (Ref: Para. A5)

For purposes of this ~~Report~~ illustrative auditor's report the following ~~of the~~ circumstances ~~described in paragraph 11(b), as follows~~are assumed:

- Audit of a complete set of financial statements of an entity other than a listed entity using Hong Kong Financial Reporting Standards (HKFRSs). The audit is not a group audit (i.e., HKSA 600 does not apply).
- The financial statements are prepared by the directors of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of the directors' responsibility for the financial statements in HKSA 210.
- The auditor's report on the prior period, as previously issued, included a qualified opinion.
- The matter giving rise to the modification is unresolved.
- The effects or possible effects of the matter on the current period's figures are immaterial but require a modification to the auditor's opinion because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with HKSA 701.
- The auditor has not obtained any other information prior to the date of the auditor's report.[6a]
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance.

INDEPENDENT AUDITOR'S REPORT

~~TO THE MEMBERS OF ABC LIMITED~~To the Members of ABC Company

(incorporated in Hong Kong with limited liability)[~~5a~~6b]

[6a] Under section 406(2) of the Hong Kong Companies Ordinance, the auditor is required to state in the auditor's report if the auditor is of the opinion that the information in a directors' report is not consistent with the financial statements. In this regard, the auditor refers to HKSA 720 (Revised) for guidance.

~~[5a] In Hong Kong, it is a common practice to disclose the place of incorporation of the company.~~

[6b] In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

~~[~~Report on the Audit of the Financial Statements~~]~~[7]

Qualified Opinion

We have audited the financial statements of ABC ~~Limited~~ Company ("the Company") set out on pages …… to ……, which comprise the statement of financial position as at 31 December 20X1, and [the statement of profit or loss and][7a] the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies ~~and other explanatory information~~.

In our opinion, except for the possible effects on the corresponding figures of the matter described in the *Basis for Qualified Opinion* section of our report, 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") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Qualified Opinion

Because we were appointed auditors of the Company during 20X0, we were not able to observe the counting of the physical inventories at the beginning of that period or satisfy ourselves concerning those inventory quantities by alternative means. Since opening inventories affect the determination of the results of operations, we were unable to determine whether adjustments to the results of operations and opening retained earnings might be necessary for 20X0. Our audit opinion on the financial statements for the period ended 31 December 20X0 was modified accordingly. Our opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures and the corresponding figures.

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") 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"), and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Responsibilities of Directors~~[1]~~ and Those Charged with Governance for the Financial Statements[8] ~~*Responsibility for the Financial Statements*~~

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 3 in HKSA 700 (Revised)*).]

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

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

[7a] HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.

[8] Or other terms that ~~is~~ are appropriate in the context of the legal framework in the particular jurisdiction.

~~[8] Not used.~~

Auditor's Responsibility~~y~~ies for the Audit of the Financial Statements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 3 in HKSA 700 (Revised)*).]

~~Our responsibility is to express an opinion on these financial statements based on our audit [8a]. We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.~~

~~An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.[10] An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.~~

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

~~*Basis for Qualified Opinion*~~

~~Because we were appointed auditors of ABC Limited during 20X0, we were not able to observe the counting of the physical inventories at the beginning of that period or satisfy ourselves concerning those inventory quantities by alternative means. Since opening inventories affect the determination of the results of operations, we were unable to determine whether adjustments to the results of operations and opening retained earnings might be necessary for 20X0. Our audit opinion on the financial statements for the period ended 31 December 20X0 was modified accordingly. Our opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures and the corresponding figures.~~

~~*Qualified Opinion*~~

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

~~[~~Report on Other Legal and Regulatory Requirements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 3 in HKSA 700 (Revised)*).]

~~[8a] Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".~~

~~[9] Not used.~~

~~[10] In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances."~~

~~[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]]~~[6]

XYZ & Co.

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

[*Auditor's A~~a~~ddress*]

[*Date*] ~~of the auditor's report~~

Illustration 3 - Corresponding Figures: (Ref: Para. A7)

For purposes of this ~~Report~~ illustrative auditor's report the following ~~of the~~ circumstances ~~described in paragraph 13, as follows~~are assumed:

- Audit of a complete set of financial statements of an entity other than a listed entity using Hong Kong Financial Reporting Standards (HKFRSs). The audit is not a group audit (i.e., HKSA 600 does not apply).
- The financial statements are prepared by the directors of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of the directors' responsibility for the financial statements in HKSA 210.
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with HKSA 701.
- The auditor has obtained all of the other information prior to the date of the auditor's report and has not identified a material misstatement of the other information.
- Corresponding figures are presented, ~~T~~the prior period's financial statements were audited by a predecessor auditor.
- The auditor is not prohibited by law or regulation from referring to the predecessor auditor's report on the corresponding figures and decides to do so.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance.

INDEPENDENT AUDITOR'S REPORT

~~TO THE MEMBERS OF ABC LIMITED~~To the Members of ABC Company

(incorporated in Hong Kong with limited liability)[8a]

~~[~~Report on the Audit of the Financial Statements~~]~~[9]

[8a] In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

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

Opinion

We have audited the financial statements of ABC ~~Limited~~ Company ("the Company") set out on pages …… to ……, which comprise the statement of financial position as at 31 December 20X1, and [the statement of profit or loss and][9a] the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies ~~and other explanatory information~~.

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") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") 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"), and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Other Matter

The financial statements of the Company for the year ended 31 December 20X0, were audited by another auditor who expressed an unmodified opinion on those statements on 31 March 20X1.

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~~[1]~~ and Those Charged with Governance for the Financial Statements[10] ~~*Responsibility for the Financial Statements*~~

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 3 in HKSA 700 (Revised*).]

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

Auditor's Responsibility~~y~~ies for the Audit of the Financial Statements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 3 in HKSA 700 (Revised*).]

[9a] HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.

[10] Or other terms that ~~is~~ are appropriate in the context of the legal framework in the particular jurisdiction.

~~Our responsibility is to express an opinion on these financial statements based on our audit[13a]. We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.~~

~~An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.[15] An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.~~

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

~~*Opinion*~~

~~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 cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in compliance with the Hong Kong Companies Ordinance.~~

~~*Other Matter*~~

~~The financial statements of the Company for the year ended 31 December 20X0, were audited by another auditor who expressed an unmodified opinion on those statements on 31 March 20X1.~~

~~[~~Report on Other Legal and Regulatory Requirements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 3 in HKSA 700 (Revised)*).]

~~[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]]~~[11]

XYZ & Co.

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

[*Auditor's ~~a~~Address*]

[*Date*] ~~of the auditor's report~~

~~[13a] Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".~~

~~[14] Not used.~~

~~[15] In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances."~~

Illustration 4 - Comparative Financial Statements[10a]: (Ref: Para. A9)

For purposes of this~~Report~~ illustrative auditor's report ~~of~~ the following circumstances ~~described in paragraph 15, as follows~~are assumed:

- Audit of a complete set of financial statements of an entity other than a listed entity using Hong Kong Financial Reporting Standards (HKFRSs). The audit is not a group audit (i.e., HKSA 600 does not apply).
- The financial statements are prepared by management of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in HKSA 210.
- The a~~A~~uditor is required to report on both the current period financial statements and the prior period financial statements in connection with the current year's audit.
- The auditor's report on the prior period, as previously issued, included a qualified opinion.
- The matter giving rise to the modification is unresolved.
- The effects or possible effects of the matter on the current period's figures are material to both the current period financial statements and prior period financial statements and require a modification to the auditor's opinion.
- The relevant ethical requirements that apply to the audit are those of the jurisdiction.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with HKSA 701.
- The auditor has not obtained any other information prior to the date of the auditor's report.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law.

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of ABC Company [or Other Appropriate Addressee]

~~[~~Report on the Audit of the Financial Statements~~]~~[11]

Qualified Opinion

[10a] The comparative financial statements as presented in this Illustration are not generally applicable to an audit performed on a Hong Kong incorporated company's annual statutory financial statements, refer to Appendix 2.

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

We have audited the financial statements of ABC ~~Limited~~ Company ("the Company") set out on pages …… to ……, which comprise the statements of financial position as at 31 December 20X1 and 20X0, and [the statement of profit or loss and][11a] the statements of profit or loss and other comprehensive income, statements of changes in equity and statements of cash flows for the years then ended, and notes to the financial statements, including a summary of significant accounting policies ~~and other explanatory information~~.

In our opinion, except for the effects of the matter described in the *Basis for Qualified Opinion* section of our report, the financial statements give a true and fair view of the financial position of the Company as at 31 December 20X1 and 20X0 and of its financial performance and its cash flows for the years then ended in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA").

Basis for Qualified Opinion

As discussed in Note X to the financial statements, no depreciation has been provided in the financial statements, which constitutes a departure from HKFRSs. Based on the straight-line method of depreciation and annual rates of 5% for the building and 20% for the equipment, the loss for the year should be increased by xxx in 20X1 and xxx in 20X0, property, plant and equipment should be reduced by accumulated depreciation of xxx in 20X1 and xxx in 20X0, and the accumulated loss should be increased by xxx in 20X1 and xxx in 20X0.

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") 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 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. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Responsibilities of Management~~'s~~ and Those Charged with Governance for the Financial Statements[12] ~~Responsibility for the Financial Statements~~

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 3 in HKSA 700 (Revised)*.]

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

Auditor's Responsibility~~y~~ies for the Audit of the Financial Statements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 3 in HKSA 700 (Revised)*.]

~~Our responsibility is to express an opinion on these financial statements based on our audits[18a]. We conducted our audits in accordance with Hong Kong Standards on Auditing issued by the Hong Kong~~

[11a] HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.

[12] Or other terms that ~~is~~ are appropriate in the context of the legal framework in the particular jurisdiction.

~~[18] Not used.~~

~~[18a] Auditors may consider it appropriate to clarify to whom they are responsible here or elsewhere in the report in accordance with their risk management policies and with reference to Professional Risk Management Bulletin No. 2 "Auditors' Duty of Care To Third Parties and The Audit Report".~~

~~[19] Not used.~~

~~Institute of Certified Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.~~

~~An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.[20] An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.~~

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

~~*Basis for Qualified Opinion*~~

~~As discussed in Note X to the financial statements, no depreciation has been provided in the financial statements, which constitutes a departure from Hong Kong Financial Reporting Standards. Based on the straight-line method of depreciation and annual rates of 5% for the building and 20% for the equipment, the loss for the year should be increased by xxx in 20X1 and xxx in 20X0, property, plant and equipment should be reduced by accumulated depreciation of xxx in 20X1 and xxx in 20X0, and the accumulated loss should be increased by xxx in 20X1 and xxx in 20X0.~~

~~*Qualified Opinion*~~

~~In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the financial statements give a true and fair view of the financial position of the Company as at 31 December 20X1 and 20X0 and of its financial performance and cash flows for the years then ended in accordance with Hong Kong Financial Reporting Standards.~~

~~[~~Report on Other Legal and Regulatory Requirements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 3 in HKSA 700 (Revised)*).]

~~[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]~~]~~[16]~~

XYZ & Co.

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

[*Auditor's ~~a~~Address*]

[*Date*]~~ of the auditor's report~~

~~[20] In circumstances when the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances."~~

Appendix 2

(Ref: Para. 3(a))

Additional Local Guidance on Corresponding Figures

In Hong Kong the corresponding figures method of presentation as described in paragraph 3(a) is used.

(a) Financial statements of companies incorporated under the provisions of the Companies Ordinance are required to disclose comparative amounts as required under the applicable accounting standards.

(b) Appendix 16 to the Main Board Rules and Chapter 18.07(5) of the GEM Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Ltd. require financial statements of listed issuers to include comparative figures for the balance sheet, income statement, cash flow statement and statement of changes in equity for the corresponding previous period.

(c) "Comparative figures" referred to by the Main Board Rules and GEM Rules refers to the corresponding figures as described in this HKSA.

The auditor's consideration of comparative financial statements as described in paragraphs 3(b), 15-19 and A8-A12~~1~~ is, therefore, not generally applicable to an audit performed on a Hong Kong incorporated company's annual statutory financial statements in accordance with HKSAs.

HKSA 720 (Revised)
Issued August 2015

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

Hong Kong Standard on Auditing 720 (Revised)

The Auditor's Responsibilities Relating to Other Information

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

HONG KONG STANDARD ON AUDITING 720 (REVISED)
THE AUDITOR'S RESPONSIBILITIES RELATING TO OTHER INFORMATION

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

CONTENTS

Appendix 1: Examples of Amounts or Other Items that May be Included in the Other Information

Appendix 2: Illustrations of Auditor's Reports Relating to Other Information

Appendix 3: Additional Local Guidance on Requirements of the Hong Kong Companies Ordinance

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Hong Kong Standard on Auditing (HKSA) 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*, should be read in conjunction with HKSA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing.

Introduction

Scope of this HKSA

1. This Hong Kong Standard on Auditing (HKSA) deals with the auditor's responsibilities relating to other information, whether financial or non-financial information (other than financial statements and the auditor's report thereon), included in an entity's annual report. An entity's annual report may be a single document or a combination of documents that serve the same purpose.

2. This HKSA is written in the context of an audit of financial statements by an independent auditor. Accordingly, the objectives of the auditor in this HKSA are to be understood in the context of the overall objectives of the auditor as stated in paragraph 11 of HKSA 200.[1] The requirements in 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 auditor's opinion on the financial statements does not cover the other information, nor does this HKSA require the auditor to obtain audit evidence beyond that required to form an opinion on the financial statements.

3. This HKSA requires the auditor to read and consider the other information because other information that is materially inconsistent with the financial statements or the auditor's knowledge obtained in the audit may indicate that there is a material misstatement of the financial statements or that a material misstatement of the other information exists, either of which may undermine the credibility of the financial statements and the auditor's report thereon. Such material misstatements may also inappropriately influence the economic decisions of the users for whom the auditor's report is prepared.

4. This HKSA may also assist the auditor in complying with relevant ethical requirements[2] that require the auditor to avoid being knowingly associated with information that the auditor believes contains a materially false or misleading statement, statements or information furnished recklessly, or omits or obscures information required to be included where such omission or obscurity would be misleading.

5. Other information may include amounts or other items that are intended to be the same as, to summarize, or to provide greater detail, about amounts or other items in the financial statements, and other amounts or other items about which the auditor has obtained knowledge in the audit. Other information may also include other matters.

6. The auditor's responsibilities relating to other information (other than applicable reporting responsibilities) apply regardless of whether the other information is obtained by the auditor prior to, or after, the date of the auditor's report.

7. This HKSA does not apply to:

   (a) Preliminary announcements of financial information; or

   (b) Securities offering documents, including prospectuses.

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

[2] HKICPA's *Code of Ethics for Professional Accountants* (the Code), paragraph 110.2

8. The auditor's responsibilities under this HKSA do not constitute an assurance engagement on other information or impose an obligation on the auditor to obtain assurance about the other information.

9. Law or regulation may impose additional obligations on the auditor in relation to other information that are beyond the scope of this HKSA.[2a]

Effective Date

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

Objectives

11. The objectives of the auditor, having read the other information, are:

    (a) To consider whether there is a material inconsistency between the other information and the financial statements;

    (b) To consider whether there is a material inconsistency between the other information and the auditor's knowledge obtained in the audit;

    (c) To respond appropriately when the auditor identifies that such material inconsistencies appear to exist, or when the auditor otherwise becomes aware that other information appears to be materially misstated; and

    (d) To report in accordance with this HKSA.

Definitions

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

    (a) Annual report – A document, or combination of documents, prepared typically on an annual basis by management or those charged with governance in accordance with law, regulation or custom, the purpose of which is to provide owners (or similar stakeholders) with information on the entity's operations and the entity's financial results and financial position as set out in the financial statements. An annual report contains or accompanies the financial statements and the auditor's report thereon and usually includes information about the entity's developments, its future outlook and risks and uncertainties, a statement by the entity's governing body, and reports covering governance matters. (Ref: Para. A1–A5)

    (b) Misstatement of the other information – A misstatement of the other information exists when the other information is incorrectly stated or otherwise misleading (including because it omits or obscures information necessary for a proper understanding of a matter disclosed in the other information). (Ref: Para. A6–A7)

    (c) Other information – Financial or non-financial information (other than financial statements and the auditor's report thereon) included in an entity's annual report. (Ref: Para. A8–A10)

[2a] Additional local guidance is provided in Appendix 3, paragraph 1.

Requirements

Obtaining the Other Information

13. The auditor shall: (Ref: Para. A11–A22)

 (a) Determine, through discussion with management, which document(s) comprises the annual report, and the entity's planned manner and timing of the issuance of such document(s);

 (b) Make appropriate arrangements with management to obtain in a timely manner and, if possible, prior to the date of the auditor's report, the final version of the document(s) comprising the annual report; and

 (c) When some or all of the document(s) determined in (a) will not be available until after the date of the auditor's report, request management to provide a written representation that the final version of the document(s) will be provided to the auditor when available, and prior to its issuance by the entity, such that the auditor can complete the procedures required by this HKSA. (Ref: Para. A22)

Reading and Considering the Other Information

14. The auditor shall read the other information and, in doing so shall: (Ref: Para. A23–A24)

 (a) Consider whether there is a material inconsistency between the other information and the financial statements. As the basis for this consideration, the auditor shall, to evaluate their consistency, compare selected amounts or other items in the other information (that are intended to be the same as, to summarize, or to provide greater detail about, the amounts or other items in the financial statements) with such amounts or other items in the financial statements; and (Ref: Para. A25–A29)

 (b) Consider whether there is a material inconsistency between the other information and the auditor's knowledge obtained in the audit, in the context of audit evidence obtained and conclusions reached in the audit. (Ref: Para. A30–A36)

15. While reading the other information in accordance with paragraph 14, the auditor shall remain alert for indications that the other information not related to the financial statements or the auditor's knowledge obtained in the audit appears to be materially misstated. (Ref: Para. A24, A37–A38)

Responding When a Material Inconsistency Appears to Exist or Other Information Appears to Be Materially Misstated

16. If the auditor identifies that a material inconsistency appears to exist (or becomes aware that the other information appears to be materially misstated), the auditor shall discuss the matter with management and, if necessary, perform other procedures to conclude whether: (Ref: Para. A39–A43)

 (a) A material misstatement of the other information exists;

 (b) A material misstatement of the financial statements exists; or

 (c) The auditor's understanding of the entity and its environment needs to be updated.

Responding When the Auditor Concludes That a Material Misstatement of the Other Information Exists

17. If the auditor concludes that a material misstatement of the other information exists, the auditor shall request management to correct the other information. If management:

    (a) Agrees to make the correction, the auditor shall determine that the correction has been made; or

    (b) Refuses to make the correction, the auditor shall communicate the matter with those charged with governance and request that the correction be made.

18. If the auditor concludes that a material misstatement exists in other information obtained prior to the date of the auditor's report, and the other information is not corrected after communicating with those charged with governance, the auditor shall take appropriate action,[2b] including: (Ref: Para. A44)

    (a) Considering the implications for the auditor's report and communicating with those charged with governance about how the auditor plans to address the material misstatement in the auditor's report (see paragraph 22(e)(ii)); or (Ref: Para. A45)

    (b) Withdrawing from the engagement, where withdrawal is possible under applicable law or regulation. (Ref: Para. A46–A47)

19. If the auditor concludes that a material misstatement exists in other information obtained after the date of the auditor's report, the auditor shall:

    (a) If the other information is corrected, perform the procedures necessary in the circumstances; or (Ref: Para. A48)

    (b) If the other information is not corrected after communicating with those charged with governance, take appropriate action considering the auditor's legal rights and obligations, to seek to have the uncorrected material misstatement appropriately brought to the attention of users for whom the auditor's report is prepared. (Ref: Para. A49–A50)

Responding When a Material Misstatement in the Financial Statements Exists or the Auditor's Understanding of the Entity and Its Environment Needs to Be Updated

20. If, as a result of performing the procedures in paragraphs 14–15, the auditor concludes that a material misstatement in the financial statements exists or the auditor's understanding of the entity and its environment needs to be updated, the auditor shall respond appropriately in accordance with the other HKSAs. (Ref: Para. A51)

Reporting

21. The auditor's report shall include a separate section with a heading "Other Information", or other appropriate heading, when, at the date of the auditor's report:

    (a) For an audit of financial statements of a listed entity, the auditor has obtained, or expects to obtain, the other information; or

    (b) For an audit of financial statements of an entity other than a listed entity, the auditor has obtained some or all of the other information. (Ref: Para. A52)

[2b] Additional local guidance is provided in Appendix 3, paragraph 3.

22. When the auditor's report is required to include an Other Information section in accordance with paragraph 21, this section shall include: (Ref: Para. A53)

    (a) A statement that management is responsible for the other information;

    (b) An identification of:

        (i) Other information, if any, obtained by the auditor prior to the date of the auditor's report; and

        (ii) For an audit of financial statements of a listed entity, other information, if any, expected to be obtained after the date of the auditor's report;

    (c) A statement that the auditor's opinion does not cover the other information and, accordingly, that the auditor does not express (or will not express) an audit opinion or any form of assurance conclusion thereon;

    (d) A description of the auditor's responsibilities relating to reading, considering and reporting on other information as required by this HKSA; and

    (e) When other information has been obtained prior to the date of the auditor's report, either:

        (i) A statement that the auditor has nothing to report; or

        (ii) If the auditor has concluded that there is an uncorrected material misstatement of the other information, a statement that describes the uncorrected material misstatement of the other information.

23. When the auditor expresses a qualified or adverse opinion in accordance with HKSA 705 (Revised),[3] the auditor shall consider the implications of the matter giving rise to the modification of opinion for the statement required in paragraph 22(e). (Ref: Para. A54–A58)

Reporting Prescribed by Law or Regulation[3a]

24. If the auditor is required by law or regulation of a specific jurisdiction to refer to the other information in the auditor's report using a specific layout or wording, the auditor's report shall refer to Hong Kong Standards on Auditing only if the auditor's report includes, at a minimum: (Ref: Para. A59)

    (a) Identification of the other information obtained by the auditor prior to the date of the auditor's report;

    (b) A description of the auditor's responsibilities with respect to the other information; and

    (c) An explicit statement addressing the outcome of the auditor's work for this purpose.

Documentation

25. In addressing the requirements of HKSA 230[4] as it applies to this HKSA, the auditor shall include in the audit documentation:

    (a) Documentation of the procedures performed under this HKSA; and

    (b) The final version of the other information on which the auditor has performed the work required under this HKSA.

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[3] HKSA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*

[3a] Additional local guidance is provided in Appendix 3, paragraphs 1 and 2.

[4] HKSA 230, *Audit Documentation,* paragraphs 8–11

Conformity and Compliance with International Standards on Auditing

26. As of August 2015 (date of issue), this HKSA conforms with International Standard on Auditing (ISA) 720 (Revised) *The Auditor's Responsibilities Relating to Other Information*. Compliance with the requirements of this HKSA ensures compliance with ISA 720 (Revised).

27. Additional local guidance is provided in footnote 4a, Appendices 2 and 3.

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Application and Other Explanatory Material

Definitions

Annual Report (Ref: Para. 12(a))

A1. Law, regulation or custom may define the content of an annual report, and the name by which it is to be referred, for entities in a particular jurisdiction; however, the content and the name may vary within a jurisdiction and from one jurisdiction to another.

A2. An annual report is typically prepared on an annual basis. However, when the financial statements being audited are prepared for a period less than or more than a year, an annual report may also be prepared that covers the same period as the financial statements.

A3. In some cases, an entity's annual report may be a single document and referred to by the title "annual report" or by some other title. In other cases, law, regulation or custom may require the entity to report to owners (or similar stakeholders) information on the entity's operations and the entity's financial results and financial position as set out in the financial statements (i.e., an annual report) by way of a single document, or by way of two or more separate documents that in combination serve the same purpose. For example, depending on law, regulation or custom in a particular jurisdiction, one or more of the following documents may form part of the annual report:

- Management report, management commentary, or operating and financial review or similar reports by those charged with governance (for example, a directors' report[4a]).
- Chairman's statement.
- Corporate governance statement.
- Internal control and risk assessment reports.

A4. An annual report may be made available to users in printed form, or electronically, including on the entity's website. A document (or combination of documents) may meet the definition of an annual report, irrespective of the manner in which it is made available to users.

A5. An annual report is different in nature, purpose and content from other reports, such as a report prepared to meet the information needs of a specific stakeholder group or a report prepared to comply with a specific regulatory reporting objective (even when such a report is required to be publicly available). Examples of reports that, when issued as standalone documents, are not typically part of the combination of documents that comprise an annual report (subject to law,

[4a] According to Schedule 5 of the Hong Kong Companies Ordinance, a director's report of a company incorporated in Hong Kong must contain a business review unless it satisfies the conditions as set out in section 388(3).

regulation or custom), and that, therefore, are not other information within the scope of this HKSA, include:

- Separate industry or regulatory reports (for example, capital adequacy reports), such as may be prepared in the banking, insurance, and pension industries.
- Corporate social responsibility reports.
- Sustainability reports.
- Diversity and equal opportunity reports.
- Product responsibility reports.
- Labor practices and working conditions reports.
- Human rights reports.

Misstatement of the Other Information (Ref: Para. 12(b))

A6. When a particular matter is disclosed in the other information, the other information may omit or obscure information that is necessary for a proper understanding of that matter. For example, if the other information purports to address the key performance indicators used by management, then omission of a key performance indicator used by management could indicate that the other information is misleading.

A7. The concept of materiality may be discussed in a framework applicable to the other information and, if so, such a framework may provide a frame of reference for the auditor in making judgments about materiality under this HKSA. In many cases, however, there may be no applicable framework that includes a discussion of the concept of materiality as it applies to the other information. In such circumstances, the following characteristics provide the auditor with a frame of reference in determining if a misstatement of the other information is material:

- Materiality is considered in the context of the common information needs of users as a group. The users of the other information are expected to be the same as the users of the financial statements as such users may be expected to read the other information to provide context to the financial statements.
- Judgments about materiality take into account the specific circumstances of the misstatement, considering whether users would be influenced by the effect of the uncorrected misstatement. Not all misstatements will influence the economic decisions of users.
- Judgments about materiality involve both qualitative and quantitative considerations. Accordingly, such judgments may take into account the nature or magnitude of the items that the other information addresses in the context of the entity's annual report.

Other Information (Ref: Para. 12(c))

A8. Appendix 1 contains examples of amounts or other items that may be included in the other information.

A9. In some cases, the applicable financial reporting framework may require specific disclosures but permit them to be located outside of the financial statements.[5] As such disclosures are

[5] For example, Hong Kong Financial Reporting Standards (HKFRS) 7, *Financial Instruments: Disclosures,* permits certain disclosures required by the HKFRSs to either be given in the financial statements or incorporated by cross-reference from the financial statements to some other statement, such as a management commentary or risk report, that is available to users of the financial statements on the same terms as the financial statements and at the same time.

required by the applicable financial reporting framework, they form part of the financial statements. Accordingly, they do not constitute other information for the purpose of this HKSA.

A10. eXtensible Business Reporting Language (XBRL) tags do not represent other information as defined in this HKSA.

Obtaining the Other Information (Ref: Para. 13)

A11. Determining the document(s) that is or comprises the annual report is often clear based on law, regulation or custom. In many cases, management or those charged with governance may have customarily issued a package of documents that together comprise the annual report, or may have committed to do so. In some cases, however, it may not be clear which document(s) is or comprises the annual report. In such cases, the timing and purpose of the documents (and for whom they are intended) are matters that may be relevant to the auditor's determination of which document(s) is or comprises the annual report.

A12. When the annual report is translated into other languages pursuant to law or regulation (such as may occur when a jurisdiction has more than one official language), or when multiple "annual reports" are prepared under different legislation (for example, when an entity is listed in more than one jurisdiction), consideration may need to be given as to whether one, or more than one of the "annual reports" form part of the other information. Local law or regulation may provide further guidance in this respect.

A13. Management, or those charged with governance, is responsible for preparing the annual report. The auditor may communicate with management or those charged with governance:

- The auditor's expectations in relation to obtaining the final version of the annual report (including a combination of documents that together comprise the annual report) in a timely manner prior to the date of the auditor's report such that the auditor can complete the procedures required by this HKSA before the date of the auditor's report, or if that is not possible, as soon as practicable and in any case prior to the entity's issuance of such information.
- The possible implications when the other information is obtained after the date of the auditor's report.

A14. The communications referred to in paragraph A13 may be particularly appropriate for example:

- In an initial audit engagement.
- When there has been a change in management or those charged with governance.
- When other information is expected to be obtained after the date of the auditor's report.

A15. Where those charged with governance are to approve the other information prior to its issuance by the entity, the final version of such other information is the one that has been approved by those charged with governance for issuance.

A16. In some cases, the entity's annual report may be a single document to be released, in accordance with law or regulation or the entity's reporting practice, shortly after the entity's financial reporting period such that it is available to the auditor prior to the date of the auditor's report. In other cases, such a document may not be required to be released until a later time, or at a time of the entity's choosing. There may also be circumstances when the entity's annual report is a combination of documents, each subject to different requirements or reporting practice by the entity with respect to the timing of their release.

A17. There may be circumstances when, at the date of the auditor's report, the entity is considering the development of a document that may be part of the entity's annual report (for example, a voluntary report to stakeholders) but management is unable to confirm to the auditor the purpose or timing of such a document. If the auditor is unable to ascertain the purpose or timing of such a document, the document is not considered other information for purposes of this HKSA.

A18. Obtaining the other information in a timely manner prior to the date of the auditor's report enables any revisions that are found to be necessary to be made to the financial statements, the auditor's report, or the other information prior to their issuance. The audit engagement letter[6] may make reference to an agreement with management to make available to the auditor the other information in a timely manner, and if possible prior to the date of the auditor's report.

A19. When other information is only made available to users via the entity's website, the version of the other information obtained from the entity, rather than directly from the entity's website, is the relevant document on which the auditor would perform procedures in accordance with this HKSA. The auditor has no responsibility under this HKSA to search for other information, including other information that may be on the entity's website, nor to perform any procedures to confirm that other information is appropriately displayed on the entity's website or otherwise has been appropriately transmitted or displayed electronically.

A20. The auditor is not precluded from dating or issuing the auditor's report if the auditor has not obtained some or all of the other information.

A21. When the other information is obtained after the date of the auditor's report, the auditor is not required to update the procedures performed in accordance with paragraphs 6 and 7 of HKSA 560.[7]

A22. HKSA 580[8] establishes requirements and provides guidance on the use of written representations. The written representation required to be requested by paragraph 13(c) regarding other information that will be available only after the date of the auditor's report is intended to support the auditor's ability to complete the procedures required by this HKSA with respect to such information. In addition, the auditor may find it useful to request other written representations, for example, that:

- Management has informed the auditor of all the documents that it expects to issue that may comprise other information;
- The financial statements and any other information obtained by the auditor prior to the date of the auditor's report are consistent with one another, and the other information does not contain any material misstatements; and
- With regard to other information that has not been obtained by the auditor prior to the date of the auditor's report, that management intends to prepare and issue such other information and the expected timing of such issuance.

Reading and Considering the Other Information (Ref: Para. 14–15)

A23. The auditor is required by HKSA 200[9] to plan and perform the audit with professional skepticism. Maintaining professional skepticism when reading and considering the other information includes, for example, recognizing that management may be overly optimistic about the success of its plans, and being alert to information that may be inconsistent with:

[6] HKSA 210, *Agreeing the Terms of Audit Engagements*, paragraph A23

[7] HKSA 560, *Subsequent Events*

[8] HKSA 580, *Written Representations*

[9] HKSA 200, paragraph 15

(a) The financial statements; or

(b) The auditor's knowledge obtained in the audit.

A24. In accordance with HKSA 220,[10] the engagement partner is required to take responsibility for the direction, supervision and performance of the audit engagement in compliance with professional standards and applicable legal and regulatory requirements. In the context of this HKSA, factors that may be taken into account when determining the appropriate engagement team members to address the requirements of paragraphs 14–15, include:

- The relative experience of engagement team members.
- Whether the engagement team members to be assigned the tasks have the relevant knowledge obtained in the audit to identify inconsistencies between the other information and that knowledge.
- The degree of judgment involved in addressing the requirements of paragraphs 14–15. For example, performing procedures to evaluate the consistency of amounts in the other information that are intended to be the same as amounts in the financial statements may be carried out by less experienced engagement team members.
- Whether, in the case of a group audit, it is necessary to make inquiries of a component auditor in addressing the other information related to that component.

Considering Whether There is a Material Inconsistency between the Other Information and the Financial Statements (Ref: Para. 14(a))

A25. Other information may include amounts or other items that are intended to be the same as, to summarize, or to provide greater detail about, the amounts or other items in the financial statements. Examples of such amounts or other items may include:

- Tables, charts or graphs containing extracts of the financial statements.
- A disclosure providing greater detail about a balance or account shown in the financial statements, such as "Revenue for 20X1 comprised XXX million from product X and YYY million from product Y."
- Descriptions of the financial results, such as "Total research and development expense was XXX in 20X1."

A26. In evaluating the consistency of selected amounts or other items in the other information with the financial statements, the auditor is not required to compare all amounts or other items in the other information that are intended to be the same as, to summarize, or to provide greater detail about, the amounts or other items in the financial statements, with such amounts or other items in the financial statements.

A27. Selecting the amounts or other items to compare is a matter of professional judgment. Factors relevant to this judgment include:

- The significance of the amount or other item in the context in which it is presented, which may affect the importance that users would attach to the amount or other item (for example, a key ratio or amount).
- If quantitative, the relative size of the amount compared with accounts or items in the financial statements or the other information to which they relate.

[10] HKSA 220, *Quality Control for an Audit of Financial Statements*, paragraph 15(a)

- The sensitivity of the particular amount or other item in the other information, for example, share based payments for senior management.

A28. Determining the nature and extent of procedures to address the requirement in paragraph 14(a) is a matter of professional judgment, recognizing that the auditor's responsibilities under this HKSA do not constitute an assurance engagement on the other information or impose an obligation to obtain assurance about the other information. Examples of such procedures include:

- For information that is intended to be the same as information in the financial statements, comparing the information to the financial statements.
- For information intended to convey the same meaning as disclosures in the financial statements, comparing the words used and considering the significance of differences in wording used and whether such differences imply different meanings.
- Obtaining a reconciliation between an amount within the other information and the financial statements from management and:
  - Comparing items in the reconciliation to the financial statements and the other information; and
  - Checking whether the calculations within the reconciliation are arithmetically accurate.

A29. Evaluating the consistency of selected amounts or other items in the other information with the financial statements includes, when relevant given the nature of the other information, the manner of their presentation compared to the financial statements.

Considering Whether There Is a Material Inconsistency between the Other Information and the Auditor's Knowledge Obtained in the Audit (Ref: Para. 14(b))

A30. Other information may include amounts or items that are related to the auditor's knowledge obtained in the audit (other than those in paragraph 14(a)). Examples of such amounts or items may include:

- A disclosure of the units produced, or a table summarizing such production by geographical region.
- A statement that "The company introduced product X and product Y during the year."
- A summary of the locations of the entity's major operations, such as "the entity's major center of operation is in country X, and there are also operations in countries Y and Z."

A31. The auditor's knowledge obtained in the audit includes the auditor's understanding of the entity and its environment, including the entity's internal control, obtained in accordance with HKSA 315 (Revised).[11] HKSA 315 (Revised) sets out the auditor's required understanding, which includes such matters as obtaining an understanding of:

(a) The relevant industry, regulatory, and other external factors;

(b) The nature of the entity;

(c) The entity's selection and application of accounting policies;

(d) The entity's objectives and strategies;

(e) The measurement and review of the entity's financial performance; and

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[11] HKSA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment,* paragraphs 11–12

(f) The entity's internal control.

A32. The auditor's knowledge obtained in the audit may also include matters that are prospective in nature. Such matters may include, for example, business prospects and future cash flows that the auditor considered when evaluating the assumptions used by management in performing impairment tests on intangible assets such as goodwill, or when evaluating management's assessment of the entity's ability to continue as a going concern.

A33. In considering whether there is a material inconsistency between the other information and the auditor's knowledge obtained in the audit, the auditor may focus on those matters in the other information that are of sufficient importance that a misstatement of the other information in relation to that matter could be material.

A34. In relation to many matters in the other information, the auditor's recollection of the audit evidence obtained and conclusions reached in the audit may be sufficient to enable the auditor to consider whether there is a material inconsistency between the other information and the auditor's knowledge obtained in the audit. The more experienced and the more familiar with the key aspects of the audit the auditor is, the more likely it is that the auditor's recollection of relevant matters will be sufficient. For example, the auditor may be able to consider whether there is a material inconsistency between the other information and the auditor's knowledge obtained in the audit in light of the auditor's recollection of discussions held with management or those charged with governance or findings from procedures carried out during the audit such as the reading of board minutes, without the need to take further action.

A35. The auditor may determine that referring to relevant audit documentation or making inquiries of relevant members of the engagement team or relevant component auditors is appropriate as a basis for the auditor's consideration of whether a material inconsistency exists. For example:

- When the other information describes the planned cessation of a major product line and, although the auditor is aware of the planned cessation, the auditor may make inquiries of the relevant engagement team member who performed the audit procedures in this area to support the auditor's consideration of whether the description is materially inconsistent with the auditor's knowledge obtained during the audit.
- When the other information describes important details of a lawsuit addressed in the audit, but the auditor cannot recall them adequately, it may be necessary to refer to the audit documentation where such details are summarized to support the auditor's recollection.

A36. Whether, and if so the extent to which, the auditor refers to relevant audit documentation, or makes inquiries of relevant members of the engagement team or relevant component auditors is a matter of professional judgment. However, it may not be necessary for the auditor to refer to relevant audit documentation, or to make inquiries of relevant members of the engagement team or relevant component auditors about any matter included in the other information.

Remaining Alert for Other Indications that the Other Information Appears to Be Materially Misstated (Ref: Para. 15)

A37. Other information may include discussion of matters that are not related to the financial statements and may also extend beyond the auditor's knowledge obtained in the audit. For example, the other information may include statements about the entity's greenhouse gas emissions.

A38. Remaining alert for other indications that the other information not related to the financial statements or the auditor's knowledge obtained in the audit appears to be materially misstated assists the auditor in complying with relevant ethical requirements that require the auditor to avoid being knowingly associated with other information that the auditor believes contains a materially false or misleading statement, a statement furnished recklessly, or omits or obscures necessary information such that the other information is misleading.[12] Remaining alert for other indications that the other information appears to be materially misstated could potentially result in the auditor identifying such matters as:

- Differences between the other information and the general knowledge, apart from the knowledge obtained in the audit, of the engagement team member reading the other information that lead the auditor to believe that the other information appears to be materially misstated; or
- An internal inconsistency in the other information that leads the auditor to believe that the other information appears to be materially misstated.

Responding When a Material Inconsistency Appears to Exist or Other Information Appears to Be Materially Misstated (Ref: Para. 16)

A39. The auditor's discussion with management about a material inconsistency (or other information that appears to be materially misstated) may include requesting management to provide support for the basis of management's statements in the other information. Based on management's further information or explanations, the auditor may be satisfied that the other information is not materially misstated. For example, management explanations may indicate reasonable and sufficient grounds for valid differences of judgment.

A40. Conversely, the discussion with management may provide further information that supports the auditor's conclusion that a material misstatement of the other information exists.

A41. It may be more difficult for the auditor to challenge management on matters of judgment than on those of a more factual nature. However, there may be circumstances where the auditor concludes that the other information contains a statement that is not consistent with the financial statements or the auditor's knowledge obtained in the audit. These circumstances may raise doubt about the other information, the financial statements, or the auditor's knowledge obtained in the audit.

A42. As there is a wide range of possible material misstatements of the other information, the nature and extent of other procedures the auditor may perform to conclude whether a material misstatement of the other information exists are matters of the auditor's professional judgment in the circumstances.

A43. When a matter is unrelated to the financial statements or the auditor's knowledge obtained in the audit, the auditor may not be able to fully assess management's responses to the auditor's inquiries. Nevertheless, based on management's further information or explanations, or following changes made by management to the other information, the auditor may be satisfied that a material inconsistency no longer appears to exist or that the other information no longer appears to be materially misstated. When the auditor is unable to conclude that a material inconsistency no longer appears to exist or that the other information no longer appears to be materially misstated, the auditor may request management to consult with a qualified third party (for example, a management's expert or legal counsel). In certain cases, after considering the responses from management's consultation, the auditor may not be able to conclude whether or not a material misstatement of the other information exists. Actions the auditor may then take include one or more of the following:

- Obtaining advice from the auditor's legal counsel;

[12] The Code, paragraph 110.2

- Considering the implications for the auditor's report for example, whether to describe the circumstances when there is a limitation imposed by management; or
- Withdrawing from the audit, where withdrawal is possible under applicable law or regulation.

Responding When the Auditor Concludes That a Material Misstatement of the Other Information Exists

Responding When the Auditor Concludes That a Material Misstatement Exists in Other Information Obtained prior to the Date of the Auditor's Report (Ref: Para. 18)

A44. The actions the auditor takes if the other information is not corrected after communicating with those charged with governance are a matter of the auditor's professional judgment. The auditor may take into account whether the rationale given by management and those charged with governance for not making the correction raises doubt about the integrity or honesty of management or those charged with governance, such as when the auditor suspects an intention to mislead. The auditor may also consider it appropriate to seek legal advice. In some cases, the auditor may be required by law, regulation or other professional standards to communicate the matter to a regulator or relevant professional body.

Reporting Implications (Ref: Para. 18(a))

A45. In rare circumstances, a disclaimer of opinion on the financial statements may be appropriate when the refusal to correct the material misstatement of the other information casts such doubt on the integrity of management and those charged with governance as to call into question the reliability of audit evidence in general.

Withdrawal from the Engagement (Ref: Para. 18(b))

A46. Withdrawal from the engagement, where withdrawal is possible under applicable law or regulation, may be appropriate when the circumstances surrounding the refusal to correct the material misstatement of the other information cast such doubt on the integrity of management and those charged with governance as to call into question the reliability of representations obtained from them during the audit.

Considerations specific to public sector entities (Ref: Para. 18(b))

A47. In the public sector, withdrawal from the engagement may not be possible. In such cases, the auditor may issue a report to the legislature providing details of the matter or may take other appropriate actions.

Responding When the Auditor Concludes That a Material Misstatement Exists in Other Information Obtained after the Date of the Auditor's Report (Ref: Para. 19)

A48. If the auditor concludes that a material misstatement exists in other information obtained after the date of the auditor's report, and such a material misstatement has been corrected, the auditor's procedures necessary in the circumstances include determining that the correction has been made (in accordance with paragraph 17(a)) and may include reviewing the steps taken by management to communicate with those in receipt of the other information, if previously issued, to inform them of the revision.

A49. If those charged with governance do not agree to revise the other information, taking appropriate action to seek to have the uncorrected misstatement appropriately brought to the attention of users for whom the auditor's report is prepared requires the exercise of professional judgment, and may be affected by relevant law or regulation in the jurisdiction. Accordingly, the auditor may consider it appropriate to seek legal advice about the auditor's legal rights and obligations.

A50. When a material misstatement of the other information remains uncorrected, appropriate actions that the auditor may take to seek to have the uncorrected material misstatement appropriately brought to the attention of users for whom the auditor's report is prepared, when permitted by law or regulation, include, for example:

- Providing a new or amended auditor's report to management including a modified section in accordance with paragraph 22, and requesting management to provide this new or amended auditor's report to users for whom the auditor's report is prepared. In doing so, the auditor may need to consider the effect, if any, on the date of the new or amended auditor's report, in view of the requirements of the HKSAs or applicable law or regulation. The auditor may also review the steps taken by management to provide the new or amended auditor's report to such users;
- Bringing the material misstatement of the other information to the attention of the users for whom the auditor's report is prepared (for example, by addressing the matter in a general meeting of shareholders);
- Communicating with a regulator or relevant professional body about the uncorrected material misstatement; or
- Considering the implications for engagement continuance (see also paragraph A46).

Responding When a Material Misstatement in the Financial Statements Exists or the Auditor's Understanding of the Entity and Its Environment Needs to Be Updated (Ref: Para. 20)

A51. In reading the other information, the auditor may become aware of new information that has implications for:

- The auditor's understanding of the entity and its environment and, accordingly, may indicate the need to revise the auditor's risk assessment.[13]
- The auditor's responsibility to evaluate the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements.[14]
- The auditor's responsibilities relating to subsequent events.[15]

Reporting (Ref: Para. 21–24)

A52. For an audit of financial statements of an entity other than a listed entity, the auditor may consider that the identification in the auditor's report of other information that the auditor expects to obtain after the date of the auditor's report would be appropriate in order to provide additional transparency about the other information that is subject to the auditor's responsibilities under this HKSA. The auditor may consider it appropriate to do so, for example, when management is able to represent to the auditor that such other information will be issued after the date of the auditor's report.

[13] HKSA 315 (Revised), paragraphs 11, 31, and A1

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

[15] HKSA 560, paragraphs 10 and 14

Illustrative Statements (Ref: Para. 21–22)

A53. Illustrative examples of the "Other Information" section of the auditor's report are included in Appendix 2.

Reporting Implications When the Auditor's Opinion on the Financial Statements Is Qualified or Adverse (Ref: Para. 23)

A54. A qualified or adverse auditor's opinion on the financial statements may not have an impact on the statement required by paragraph 22(e) if the matter in respect of which the auditor's opinion has been modified is not included or otherwise addressed in the other information and the matter does not affect any part of the other information. For example, a qualified opinion on the financial statements because of non-disclosure of directors' remuneration as required by the applicable financial reporting framework may have no implications for the reporting required under this HKSA. In other circumstances, there may be implications for such reporting as described in paragraphs A55–A58.

Qualified Opinion Due to a Material Misstatement in the Financial Statements

A55. In circumstances when the auditor's opinion is qualified, consideration may be given as to whether the other information is also materially misstated for the same matter as, or a related matter to, the matter giving rise to the qualified opinion on the financial statements.

Qualified Opinion Due to Limitation of Scope

A56. When there is a limitation of scope with respect to a material item in the financial statements, the auditor will not have obtained sufficient appropriate audit evidence about that matter. In these circumstances, the auditor may be unable to conclude whether or not the amounts or other items in the other information related to this matter result in a material misstatement of the other information. Accordingly, the auditor may need to modify the statement required by paragraph 22(e) to refer to the auditor's inability to consider management's description of the matter in the other information in respect of which the auditor's opinion on the financial statements has been qualified as explained in the Basis for Qualified Opinion paragraph. The auditor is nevertheless required to report any other uncorrected material misstatements of the other information that have been identified.

Adverse Opinion

A57. An adverse opinion on the financial statements relating to a specific matter(s) described in the Basis for Adverse Opinion paragraph does not justify the omission of reporting of material misstatements of the other information that the auditor has identified in the auditor's report in accordance with paragraph 22(e)(ii). When an adverse opinion has been expressed on the financial statements, the auditor may need to appropriately modify the statement required by paragraph 22(e) for example, to indicate that amounts or items in the other information is materially misstated for the same matter as, or a related matter to, the matter giving rise to the adverse opinion on the financial statements.

Disclaimer of Opinion

A58. When the auditor disclaims an opinion on the financial statements, providing further details about the audit, including a section to address other information may overshadow the disclaimer of opinion on the financial statements as a whole. Accordingly, in those circumstances, as required by HKSA 705 (Revised), the auditor's report does not include a section addressing the reporting requirements under this HKSA.

Reporting Prescribed by Law or Regulation (Ref: Para. 24)

A59. HKSA 200[16] explains that the auditor may be required to comply with legal or regulatory requirements in addition to the HKSAs. Where this is the case, the auditor may be obliged to use a specific layout or wording in the auditor's report that differs from that described in this HKSA. Consistency in the auditor's report, when the audit has been conducted in accordance with HKSAs, promotes credibility in the global marketplace by making more readily identifiable those audits that have been conducted in accordance with globally recognized standards. When the differences between the legal or regulatory requirements to report with respect to the other information and this HKSA relate only to the layout and wording in the auditor's report and, at a minimum, each of the elements identified in paragraph 24 is included in the auditor's report, the auditor's report may refer to Hong Kong Standards on Auditing. Accordingly, in such circumstances the auditor is considered to have complied with the requirements of this HKSA, even when the layout and wording used in the auditor's report are specified by legal or regulatory reporting requirements.

[16] HKSA 200, paragraph A55

Appendix 1

(Ref: Para. 14, A8)

Examples of Amounts or Other Items that May Be Included in the Other Information

The following are examples of amounts and other items that may be included in other information. This list is not intended to be exhaustive.

Amounts

- Items in a summary of key financial results, such as net income, earnings per share, dividends, sales and other operating revenues, and purchases and operating expenses.
- Selected operating data, such as income from continuing operations by major operating area, or sales by geographical segment or product line.
- Special items, such as asset dispositions, litigation provisions, asset impairments, tax adjustments, environmental remediation provisions, and restructuring and reorganization expenses.
- Liquidity and capital resource information, such as cash, cash equivalents and marketable securities; dividends; and debt, capital lease and minority interest obligations.
- Capital expenditures by segment or division.
- Amounts involved in, and related financial effects of, off-balance sheet arrangements.
- Amounts involved in guarantees, contractual obligations, legal or environmental claims, and other contingencies.
- Financial measures or ratios, such as gross margin, return on average capital employed, return on average shareholders' equity, current ratio, interest coverage ratio and debt ratio. Some of these may be directly reconcilable to the financial statements.

Other Items

- Explanations of critical accounting estimates and related assumptions.
- Identification of related parties and descriptions of transactions with them.
- Articulation of the entity's policies or approach to manage commodity, foreign exchange or interest rate risks, such as through the use of forward contracts, interest rate swaps, or other financial instruments.
- Descriptions of the nature of off-balance sheet arrangements.
- Descriptions of guarantees, indemnifications, contractual obligations, litigation or environmental liability cases, and other contingencies, including management's qualitative assessments of the entity's related exposures.
- Descriptions of changes in legal or regulatory requirements, such as new tax or environmental regulations, that have materially impacted the entity's operations or fiscal position, or will have a material impact on the entity's future financial prospects.

- Management's qualitative assessments of the impacts of new financial reporting standards that have come into effect during the period, or will come into effect in the following period, on the entity's financial results, financial position and cash flows.
- General descriptions of the business environment and outlook.
- Overview of strategy.
- Descriptions of trends in market prices of key commodities or raw materials.
- Contrasts of supply, demand and regulatory circumstances between geographic regions.
- Explanations of specific factors influencing the entity's profitability in specific segments.

Appendix 2

(Ref: Para. 21–22, A53)

Illustrations of Auditor's Reports Relating to Other Information

- Illustration 1: An auditor's report of any entity, whether listed or other than listed, containing an unmodified opinion when the auditor has obtained all of the other information prior to the date of the auditor's report and has not identified a material misstatement of the other information.
- Illustration 2: An auditor's report of a listed entity containing an unmodified opinion when the auditor has obtained part of the other information prior to the date of the auditor's report, has not identified a material misstatement of the other information, and expects to obtain other information after the date of the auditor's report.
- Illustration 3: An auditor's report of an entity other than a listed entity containing an unmodified opinion when the auditor has obtained part of the other information prior to the date of the auditor's report, has not identified a material misstatement of the other information, and expects to obtain other information after the date of the auditor's report.
- Illustration 4: An auditor's report of a listed entity containing an unmodified opinion when the auditor has obtained no other information prior to the date of the auditor's report but expects to obtain other information after the date of the auditor's report.
- Illustration 5: An auditor's report of any entity, whether listed or other than listed, containing an unmodified opinion when the auditor has obtained all of the other information prior to the date of the auditor's report and has concluded that a material misstatement of the other information exists.
- Illustration 6: An auditor's report of any entity, whether listed or other than listed, containing a qualified opinion when the auditor has obtained all of the other information prior to the date of the auditor's report and there is a limitation of scope with respect to a material item in the consolidated financial statements which also affects the other information.
- Illustration 7: An auditor's report of any entity, whether listed or other than listed, containing an adverse opinion when the auditor has obtained all of the other information prior to the date of the auditor's report and the adverse opinion on the consolidated financial statements also affects the other information.
- Illustration 8: An auditor's report of any entity incorporated in Hong Kong, whether listed or other than listed, containing an unmodified opinion when the auditor has obtained all of the other information prior to the date of the auditor's report and has concluded that a material misstatement of the other information exists and has identified an inconsistency between the information in the directors' report and the financial statements.

Illustration 1 – An auditor's report of any entity, whether listed or other than listed, containing an unmodified opinion when the auditor has obtained all of the other information prior to the date of the auditor's report and has not identified a material misstatement of the other information.

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of any entity, whether listed or other than listed, using Hong Kong Financial Reporting Standards (HKFRSs). The audit is not a group audit (i.e., HKSA 600[1] does not apply).
- The financial statements are prepared by the directors of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of the directors' responsibility for the financial statements in HKSA 210.
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).[2]
- Key audit matters have been communicated in accordance with HKSA 701.[3]
- The auditor has obtained all of the other information prior to the date of the auditor's report and has not identified a material misstatement of the other information.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company

(incorporated in Hong Kong with limited liability)[3a]

Report on the Audit of the Financial Statements[4]

Opinion

We have audited the financial statements of ABC Company ("the Company") set out on pages …… to ……, which comprise the statement of financial position as at 31 December 20X1, and [the statement

1 HKSA 600, *Special Considerations–Audits of Group Financial Statements (Including the Work of Component Auditors)*

2 HKSA 570 (Revised), *Going Concern*

3 HKSA 701, *Communicating Key Audit Matters in the Independent Auditor's Report.* The Key Audit Matters section is required for listed entities only.

3a In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

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

of profit or loss and][4a] the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

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") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") 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"), and we have fulfilled our other ethical responsibilities in accordance with 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**[5]

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"]

The directors[6] are responsible for the other information. The other information comprises the [information included in the X report,[7] but does not include the financial statements and our auditor's report thereon.]

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material

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4a HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.

5 The Key Audit Matters section is required for listed entities only.

6 Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction

7 A more specific description of the other information, such as "the directors' report and chairman's statement," may be used to identify the other information.

misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Directors and Those Charged with Governance for the Financial Statements[8]

[*Reporting in accordance with HKSA 700 (Revised)*[9] *– see Illustration 1 or 3 in HKSA 700 (Revised).*]

Auditor's Responsibilities for the Audit of the Financial Statements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 1 or 3 in HKSA 700 (Revised).*]

Report on Other Legal and Regulatory Requirements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 1 or 3 in HKSA 700 (Revised).*]

[The engagement partner on the audit resulting in this independent auditor's report is [*name*].[10]]

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants [*Auditor Address*]

[*Date*]

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

9 HKSA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

10 The name of the engagement partner is included in the auditor's report for audits of complete sets of general purpose financial statements of listed entities unless, in rare circumstances, such disclosure is reasonably expected to lead to a significant personal security threat (see HKSA 700 (Revised), paragraph 46).

Illustration 2 – An auditor's report of a listed entity containing an unmodified opinion when the auditor has obtained part of the other information prior to the date of the auditor's report, has not identified a material misstatement of the other information, and expects to obtain other information after the date of the auditor's report.

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of a listed entity using Hong Kong Financial Reporting Standards (HKFRSs). The audit is not a group audit (i.e., HKSA 600 does not apply).
- The financial statements are prepared by the directors of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of the directors' responsibility for the financial statements in HKSA 210.
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).
- Key audit matters have been communicated in accordance with HKSA 701.
- The auditor has obtained part of the other information (including the directors' report)[10a] prior to the date of the auditor's report, has not identified a material misstatement of the other information, and expects to obtain other information after the date of the auditor's report.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company

(incorporated in Hong Kong with limited liability)[10b]

Report on the Audit of the Financial Statements[11]

Opinion

We have audited the financial statements of ABC Company ("the Company") set out on pages …… to ……, which comprise the statement of financial position as at 31 December 20X1, and [the statement

10a For a company incorporated in Hong Kong, its auditor is required to comply with section 406(2) of the Hong Kong Companies Ordinance and therefore it is normally expected the auditor should have obtained the director's report of the company prior to the date of the auditor's report. For exception reporting under section 406(2), please refer to Illustration 8 for guidance.

10b In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

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

of profit or loss and][11a] the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

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") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") 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"), and we have fulfilled our other ethical responsibilities in accordance with 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"]

The directors[12] are responsible for the other information. The other information comprises the X report[13] (but does not include the financial statements and our auditor's report thereon), which we obtained prior to the date of this auditor's report, and the Y report, which is expected to be made available to us after that date.

Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

[11a] HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.

[12] Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction.

[13] A more specific description of the other information, such as "the directors' report and chairman's statement," may be used to identify the other information.

If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

[When we read the Y report, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance and [*describe actions applicable in the jurisdiction*]][14]

Responsibilities of Directors and Those Charged with Governance for the Financial Statements[15]

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 1 in HKSA 700 (Revised).*]

Auditor's Responsibilities for the Audit of the Financial Statements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 1 in HKSA 700 (Revised).*]

Report on Other Legal and Regulatory Requirements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 1 in HKSA 700 (Revised).*]

The engagement partner on the audit resulting in this independent auditor's report is [*name*].[16]

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[*Auditor Address*]

[*Date*]

14 This additional paragraph may be useful when the auditor has identified an uncorrected material misstatement of the other information obtained after the date of the auditor's report and has a legal obligation to take specific action in response.

15 Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction

16 The name of the engagement partner is included in the auditor's report for audits of complete sets of general purpose financial statements of listed entities unless, in rare circumstances, such disclosure is reasonably expected to lead to a significant personal security threat (see HKSA 700 (Revised), paragraph 46).

Illustration 3 – An auditor's report of an entity other than a listed entity containing an unmodified opinion when the auditor has obtained part of the other information prior to the date of the auditor's report, has not identified a material misstatement of the other information, and expects to obtain other information after the date of the auditor's report.

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of an entity other than a listed entity using Hong Kong Financial Reporting Standards (HKFRSs). The audit is not a group audit (i.e., HKSA 600 does not apply).
- The financial statements are prepared by the directors of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of the directors' responsibility for the financial statements in HKSA 210.
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with HKSA 701.
- The auditor has obtained part of the other information (including the director's report)[16a] prior to the date of the auditor's report, has not identified a material misstatement of the other information, and expects to obtain other information after the date of the auditor's report.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- The auditor has no other reporting responsibilities required under law or regulation except for the Hong Kong Companies Ordinance.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company

(incorporated in Hong Kong with limited liability)[16b]

Opinion

We have audited the financial statements of ABC Company ("the Company") set out on pages …… to ……, which comprise the statement of financial position as at 31 December 20X1, and [the statement

[16a] For a company incorporated in Hong Kong, its auditor is required to comply with section 406(2) of the Hong Kong Companies Ordinance and therefore it is normally expected the auditor should have obtained the director's report of the company prior to the date of the auditor's report. For exception reporting under section 406(2), please refer to Illustration 8 for guidance.

[16b] In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

of profit or loss and][16c] the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

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") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") 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"), and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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

The directors[17] are responsible for the other information. The other information obtained at the date of this auditor's report is [information included in the X report,[18] but does not include the financial statements and our auditor's report thereon]

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed on the other information obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Directors and Those Charged with Governance for the Financial Statements[19]

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 3 in HKSA 700 (Revised).*]

[16c] HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.

[17] Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction

[18] A more specific description of the other information, such as "the directors' report and chairman's statement," may be used to identify the other information.

[19] Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction

Auditor's Responsibilities for the Audit of the Financial Statements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 3 in HKSA 700 (Revised).*]

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[*Auditor Address*]

[*Date*]

Illustration 4 – An auditor's report of a listed entity containing an unmodified opinion when the auditor has obtained no other information prior to the date of the auditor's report but expects to obtain other information after the date of the auditor's report.[19a]

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of a listed entity using Hong Kong Financial Reporting Standards (HKFRSs). The audit is not a group audit (i.e., HKSA 600 does not apply).
- The financial statements are prepared by management of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in HKSA 210.
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit are those of the jurisdiction..
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).
- Key audit matters have been communicated in accordance with HKSA 701.
- The auditor has obtained no other information prior to the date of the auditor's report but expects to obtain other information after the date of the auditor's report.[19a]
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law.

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of ABC Company [or Other Appropriate Addressee]

Report on the Audit of the Financial Statements[20]

Opinion

We have audited the financial statements of ABC Company ("the Company") set out on pages …… to ……, which comprise the statement of financial position as at 31 December 20X1, and [the statement of profit or loss and][20a] the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

[19a] For a company incorporated in Hong Kong, its auditor is required to comply with section 406(2) of the Hong Kong Companies Ordinance and therefore it is normally expected the auditor should have obtained the director's report of the company prior to the date of the auditor's report. Therefore, this illustration is generally not applicable for a company incorporated in Hong Kong.

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

[20a] HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.

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") [and have been properly prepared in compliance with the disclosure requirements of the Hong Kong Companies Ordinance] [20b].

Basis for Opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") 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 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. 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"]

Management [21] is responsible for the other information. The other information comprises the [information included in the X report, [22] but does not include the financial statements and our auditor's report thereon]. The X report is expected to be made available to us after the date of this auditor's report.

Our opinion on the financial statements does not cover the other information and we will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

[When we read the X report, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance and [*describe actions applicable in the jurisdiction*].][23]

[20b] For a company incorporated overseas and listed in Hong Kong, the disclosure requirements of the Hong Kong Companies Ordinance are applicable.

[21] Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction.

[22] A more specific description of the other information, such as "the management report and chairman's statement," may be used to identify the other information.

[23] This additional paragraph may be useful when the auditor has identified an uncorrected material misstatement of the other information obtained after the date of the auditor's report and has a legal obligation to take specific action in response.

Responsibilities of Management and Those Charged with Governance for the Financial Statements [20b, 24]

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 1or 6 in HKSA 700 (Revised).*]

Auditor's Responsibilities for the Audit of the Financial Statements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 1 in HKSA 700 (Revised).*]

Report on Other Legal and Regulatory Requirements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 1 in HKSA 700 (Revised).*]

The engagement partner on the audit resulting in this independent auditor's report is [*name*].

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[*Auditor Address*]

[*Date*]

[24] Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction

Illustration 5 – An auditor's report of any entity, whether listed or other than listed, containing an unmodified opinion when the auditor has obtained all of the other information prior to the date of the auditor's report and has concluded that a material misstatement of the other information exists.

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of any entity, whether listed or other than listed, using Hong Kong Financial Reporting Standards (HKFRSs). The audit is not a group audit (i.e., HKSA 600 does not apply).
- The financial statements are prepared by the directors of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of the directors' responsibility for the financial statements in HKSA 210.
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).
- Key audit matters have been communicated in accordance with HKSA 701.
- The auditor has obtained all of the other information prior to the date of the auditor's report and has concluded that a material misstatement of the other information exists
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- The auditor has no other reporting responsibilities required under law or regulation except for the Hong Kong Companies Ordinance.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company
(incorporated in Hong Kong with limited liability)[24a]

Opinion

We have audited the financial statements of ABC Company ("the Company") set out on pages …… to ……, which comprise the statement of financial position as at 31 December 20X1, and [the statement of profit or loss and][24b] the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

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") and have been properly prepared in compliance with

24a In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

24b HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.

the Hong Kong Companies Ordinance.

Basis for Opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") 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"), and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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

The directors[25] are responsible for the other information. The other information comprises the [information included in the X report,[26] but does not include the financial statements and our auditor's report thereon.]

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. As described below, we have concluded that such a material misstatement of the other information exists.

[*Description of material misstatement of the other information*]

[**Key Audit Matters**[27]

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.*]]

Responsibilities of Directors and Those Charged with Governance for the Financial Statements[28]

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 1 or 3 in HKSA 700 (Revised).*]

Auditor's Responsibilities for the Audit of the Financial Statements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 1 or 3 in HKSA 700 (Revised).*]

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[25] Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction

[26] A more specific description of the other information, such as "the directors' report and chairman's statement," may be used to identify the other information.

[27] The Key Audit Matters section is required for listed entities only.

[28] Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction

[The engagement partner on the audit resulting in this independent auditor's report is [*name*].[29]]

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[*Auditor Address*]

[*Date*]

29 The name of the engagement partner is included in the auditor's report for audits of complete sets of general purpose financial statements of listed entities unless, in rare circumstances, such disclosure is reasonably expected to lead to a significant personal security threat (see HKSA 700 (Revised), paragraph 46).

Illustration 6 – An auditor's report of any entity, whether listed or other than listed, containing an qualified opinion when the auditor has obtained all of the other information prior to the date of the auditor's report and there is a limitation of scope with respect to a material item in the consolidated financial statements which also affects the other information.

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of consolidated financial statements of any entity, whether listed or other than listed, using Hong Kong Financial Reporting Standards (HKFRSs). The audit is a group audit (i.e., HKSA 600 applies).
- The consolidated financial statements are prepared by the directors of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of the directors' responsibility for the consolidated financial statements in HKSA 210.
- The auditor was unable to obtain sufficient appropriate audit evidence regarding an investment in a foreign associate. The possible effects of the inability to obtain sufficient appropriate audit evidence are deemed to be material but not pervasive to the consolidated financial statements (i.e., a qualified opinion is appropriate).
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).
- Key audit matters have been communicated in accordance with HKSA 701.
- The auditor has obtained all of the other information prior to the date of the auditor's report and the matter giving rise to the qualified opinion on the consolidated financial statements also affects the other information
- Those responsible for oversight of the consolidated financial statements differ from those responsible for the preparation of the consolidated financial statements.
- The auditor has no other reporting responsibilities required under law or regulation except for the Hong Kong Companies Ordinance.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company

(incorporated in Hong Kong with limited liability)[29a]

Qualified Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries ("the Group") set out on pages …… to ……, which comprise the consolidated statement of financial position as at 31 December 20X1, and [the consolidated statement of profit or loss and][29b] the consolidated statement of profit or loss and other comprehensive income, consolidated statement of

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[29a] In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

[29b] HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.

changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, except for the possible effects of the matter described in the *Basis for Qualified Opinion* section of our report, the consolidated financial statements give a true and fair view of the financial position of the Group as at 31 December 20X1, and of its consolidated financial performance and its consolidated 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") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Qualified Opinion

The Group's investment in DEF Company, a foreign associate acquired during the year and accounted for by the equity method, is carried at xxx on the consolidated statement of financial position as at 31 December 20X1, and ABC's share of DEF's net income of xxx is included in ABC's income for the year then ended. We were unable to obtain sufficient appropriate audit evidence about the carrying amount of ABC's investment in DEF as at 31 December 20X1 and ABC's share of DEF's net income for the year because we were denied access to the financial information, management, and the auditors of DEF. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.

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

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

The directors[30] are responsible for the other information. The other information comprises the [information included in the X report,[31] but does not include the consolidated financial statements and our auditor's report thereon.]

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. As described in the *Basis for Qualified Opinion* section above, we were unable to obtain sufficient appropriate evidence about the carrying amount of ABC's investment in DEF as at 31 December 20X1 and ABC's share of DEF's net income for the

[30] Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction

[31] A more specific description of the other information, such as "the directors' report and chairman's statement," may be used to identify the other information.

year. Accordingly, we are unable to conclude whether or not the other information is materially misstated with respect to this matter.

[**Key Audit Matters**[32]

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. In addition to the matter described in the *Basis for Qualified Opinion* section we have determined the matters described below to be the key audit matters to be communicated in our report.

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

Responsibilities of Directors and Those Charged with Governance for the Financial Statements[33]

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 2 or 4 in HKSA 700 (Revised).*]

Auditor's Responsibilities for the Audit of the Financial Statements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 2 or 4 in HKSA 700 (Revised).*]

[The engagement partner on the audit resulting in this independent auditor's report is [*name*].[34]]

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[*Auditor Address*]

[*Date*]

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[32] The Key Audit Matters section is required for listed entities only.

[33] Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction

[34] The name of the engagement partner is included in the auditor's report for audits of complete sets of general purpose financial statements of listed entities unless, in rare circumstances, such disclosure is reasonably expected to lead to a significant personal security threat (see HKSA 700 (Revised), paragraph 46).

Illustration 7 – An auditor's report of any entity, whether listed or other than listed, containing an adverse opinion when the auditor has obtained all of the other information prior to the date of the auditor's report and the adverse opinion on the consolidated financial statements also affects the other information.

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of consolidated financial statements of any entity, whether listed or other than listed, using Hong Kong Financial Reporting Standards (HKFRSs). The audit is a group audit (i.e., HKSA 600 applies).
- The consolidated financial statements are prepared by the directors of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of the directors' responsibility for the consolidated financial statements in HKSA 210.
- The consolidated financial statements are materially misstated due to the non-consolidation of a subsidiary. The material misstatement is deemed to be pervasive to the consolidated financial statements. The effects of the misstatement on the consolidated financial statements have not been determined because it was not practicable to do so (i.e., an adverse opinion is appropriate).
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).
- Key audit matters have been communicated in accordance with HKSA 701.
- The auditor has obtained all of the other information prior to the date of the auditor's report and the matter giving rise to the adverse opinion on the consolidated financial statements also affects the other information
- Those responsible for oversight of the consolidated financial statements differ from those responsible for the preparation of the consolidated financial statements.
- The auditor has no other reporting responsibilities required under law or regulation except for the Hong Kong Companies Ordinance.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company

(incorporated in Hong Kong with limited liability)[34a]

Adverse Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries ("the Group") set out on pages …… to ……, which comprise the consolidated statement of financial position as at 31 December 20X1, and [the consolidated statement of profit or loss and][34b] the consolidated statement of profit or loss and other comprehensive income, consolidated statement of

[34a] In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

[34b] HKAS 1 allows entities to present comprehensive income using either a one statement approach (i.e. a single "statement of profit or loss and other comprehensive income") or a two-statement approach (i.e. a "statement of profit or loss" together with a "statement of profit or loss and other comprehensive income"). Different terms may be used as long as they are consistent with the titles of the corresponding statements.

changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, because of the significance of the matter discussed in the *Basis for Adverse Opinion* section of our report, the consolidated financial statements do not give a true and fair view of the consolidated financial position of the Group as at 31 December 20X1, and of its consolidated financial performance and its consolidated 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") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Adverse Opinion

As explained in Note X, the Group has not consolidated subsidiary DEF Company that the Group acquired during 20X1 because it has not yet been able to determine the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This investment is therefore accounted for on a cost basis. Under HKFRSs, the Group should have consolidated this subsidiary and accounted for the acquisition based on provisional amounts. Had DEF Company been consolidated, many elements in the accompanying consolidated financial statements would have been materially affected. The effects on the consolidated financial statements of the failure to consolidate have not been determined.

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

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

The directors[35] are responsible for the other information. The other information comprises the [information included in the X report,[36] but does not include the consolidated financial statements and our auditor's report thereon.]

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. As described in the *Basis for Adverse Opinion* section above, the Group should have consolidated DEF Company and accounted for the acquisition based on provisional amounts. We have concluded that

[35] Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction

[36] A more specific description of the other information, such as "the directors' report and chairman's statement," may be used to identify the other information.

the other information is materially misstated for the same reason with respect to the amounts or other items in the X report affected by the failure to consolidate DEF Company.

[**Key Audit Matters**[37]

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. In addition to the matter described in the *Basis for Adverse Opinion* section we have determined the matters described below to be the key audit matters to be communicated in our report.

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

Responsibilities of Directors and Those Charged with Governance for the Financial Statements[38]

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 2 or 4 in HKSA 700 (Revised).*]

Auditor's Responsibilities for the Audit of the Financial Statements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 2 or 4 in HKSA 700 (Revised).*]

[The engagement partner on the audit resulting in this independent auditor's report is [*name*].[39]]

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[*Auditor Address*]

[*Date*]

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37 The Key Audit Matters section is required for listed entities only.

38 Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction

39 The name of the engagement partner is included in the auditor's report for audits of complete sets of general purpose financial statements of listed entities unless, in rare circumstances, such disclosure is reasonably expected to lead to a significant personal security threat (see HKSA 700 (Revised), paragraph 46).

Illustration 8 – An auditor's report of any entity incorporated in Hong Kong, whether listed or other than listed, containing an unmodified opinion when the auditor has obtained all of the other information prior to the date of the auditor's report and has concluded that a material misstatement of the other information exists and has identified an inconsistency between the information in the directors' report and the financial statements.

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of any entity, whether listed or other than listed, using Hong Kong Financial Reporting Standards (HKFRSs). The audit is not a group audit (i.e., HKSA 600 does not apply).
- The financial statements are prepared by the directors of the entity in accordance with HKFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of the directors' responsibility for the financial statements in HKSA 210.
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit are those of the Hong Kong Institute of Certified Public Accountants' *Code of Ethics for Professional Accountants*.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with HKSA 570 (Revised).
- Key audit matters have been communicated in accordance with HKSA 701.
- The auditor has obtained all of the other information prior to the date of the auditor's report and has concluded that a material misstatement of the other information exists.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has no other reporting responsibilities required under local law except for the Hong Kong Companies Ordinance.
- The information in the directors' report is not consistent with the financial statements.

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company

(incorporated in Hong Kong with limited liability)[40]

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of ABC Company ("the Company") set out on pages …… to ……, which comprise the statement of financial position as at 31 December 20X1, and [the statement of profit or loss and][41] the statement of profit or loss and other comprehensive income, statement of

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

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

changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

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") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") 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"), and we have fulfilled our other ethical responsibilities in accordance with 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**[42]

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"]

The directors[43] are responsible for the other information. The other information comprises the [information included in the X report,[44] but does not include the financial statements and our auditor's report thereon.]

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact . As described below, we have concluded that such a material misstatement of the other information exists.

[*Description of material misstatement of the other information*]

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42 The Key Audit Matters section is required for listed entities only.

43 Or other terms that are appropriate in the context of the legal framework of the particular jurisdiction

44 A more specific description of the other information, such as "the directors' report and chairman's statement," may be used to identify the other information.

Responsibilities of Directors and Those Charged with Governance for the Financial Statements[45]

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 1 or 3 in HKSA 700 (Revised).*]

Auditor's Responsibilities for the Audit of the Financial Statements

[*Reporting in accordance with HKSA 700 (Revised) – see Illustration 1 or 3 in HKSA 700 (Revised).*]

Report on the Directors' Report under section 406(2)[46] of the Hong Kong Companies Ordinance

Directors' and Auditor's Respective Responsibilities for the Directors' Report[46]

In addition to the respective responsibilities of the directors and auditor stated in the above section "Report on the Audit of the Financial Statements", the directors are also responsible for the preparation of the directors' report as set out on pages … to … in compliance with the Hong Kong Companies Ordinance.

It is our responsibility under section 406(2) of the Hong Kong Companies Ordinance to state in our auditor's report if we are of the opinion that the information in the directors' report is not consistent with the financial statements. However, we have not audited or reviewed the directors' report and accordingly do not express an audit opinion or a review conclusion or any other assurance conclusion on the directors' report as a whole.

Matters on Which We are Required to Report by Exception

In accordance with the Hong Kong Companies Ordinance, we have the following matters to report. In our opinion, the information given in [*insert relevant paragraph/ section*] in the directors' report for the year ended 31 December 20X1 is not consistent with the financial statements for the year ended 31 December 20X1. [*State the details of the inconsistencies*[46].]

[The engagement partner on the audit resulting in this independent auditor's report is [*name*].[47]]

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants [*Auditor Address*]

[*Date*]

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

46 Section 406(2) of the Hong Kong Companies Ordinance (CO) states that if a company's auditor is of the opinion that the information in a directors' report for a financial year is not consistent with the financial statements for the financial year, the auditor-

(a) must state that opinion in the auditor's report; and

(b) may bring that opinion to the members' attention at a general meeting.

47 The name of the engagement partner is included in the auditor's report for audits of complete sets of general purpose financial statements of listed entities unless, in rare circumstances, such disclosure is reasonably expected to lead to a significant personal security threat (see HKSA 700 (Revised), paragraph 46).

Appendix 3

(Ref: Para. 9, 18 and 24)

Additional Local Guidance on Requirements of the Hong Kong Companies Ordinance

1. Section 406(2) of the Hong Kong Companies Ordinance states that if a company's auditor is of the opinion that the information in a directors' report for a financial year is not consistent with the financial statements for the financial year, the auditor

   (a) must state that opinion in the auditor's report; and

   (b) may bring that opinion to the members' attention at a general meeting.

   The auditor is required to report by exception under section 406(2). An example is set out in Illustration 8 in Appendix 2 of this HKSA for guidance. In the circumstances where the information in a directors' report is not consistent with the financial statements, the auditor must state that opinion and a description of the inconsistencies under the last section "Report on the Directors' Report under section 406(2) of the Hong Kong Companies Ordinance" of the auditor's report. Such inconsistencies would also be expected to be included under the section "Other Information" in accordance with paragraph 22 of this HKSA.

   If the auditor is of the opinion that there is no inconsistency and has nothing to report under section 406(2), the last section "Report on Directors' Report under section 406(2) of the Hong Kong Companies Ordinance" in Illustration 8 is not necessary (nor a statement that the auditor has nothing to report under Section 406(2) is required) and the auditor refers to Illustration 1 in Appendix 2 instead.

2. An auditor who is considering the course of reporting in the auditor's report on a material inconsistency between the financial statements and the other information or a material misstatement of fact in the other information (with the exception of reporting inconsistencies with the director's report) is advised that the qualified privilege (i.e. the defence to an action for defamation) which an auditor's report normally enjoys may not extend to comments on items of the other information. Similarly, no qualified privilege may attach to statements made by the auditor on such matter at a general meeting pursuant to his right under section 411 of the Companies Ordinance. The auditor would also bear in mind the provisions of sections 417 and 424 of the Companies Ordinance before deciding whether resignation from the engagement would be likely to resolve the matter. The auditor would consider seeking legal advice both as to which course of action to adopt and as to the precise form of any wording to be used.

3. If an amendment is necessary to the other information and the entity refuses to make the amendment, the auditor's possible further courses of action may involve using the auditor's right under section 411 of the Companies Ordinance to be heard at any general meeting of the members on any business of the meeting which concerns the person as auditor.

HKSA 810

Issued October 2009; revised March 2011,

September 2014*, August 2015**

Effective for engagements

for periods beginning on or after 15 December 2009

Hong Kong Standard on Auditing 810

Engagements to Report on Summary Financial Statements

** Conforming amendments have been made to this HKSA as a result of the new and revised HKSAs issued in Update 172, and will become effective for audits of financial statements for periods ending on or after 15 December 2016. The conforming amendments are underlined for easy reference.

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

HKSA 810 was issued in October 2009 and revised in July 2010 (Update 90) and March 2011 (Update 105).

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

HONG KONG STANDARD ON AUDITING 810

ENGAGEMENTS TO REPORT ON SUMMARY FINANCIAL STATEMENTS

(Effective for engagements for periods beginning on or after 15 December 2009)

CONTENTS

Hong Kong Standard on Auditing (HKSA) 810, “Engagements to Report on Summary Financial Statements” should be read in conjunction with HKSA 200, “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing.”

Introduction

Scope of this HKSA

1. This Hong Kong Standard on Auditing (HKSA) deals with the auditor's responsibilities relating to an engagement to report on summary financial statements derived from financial statements audited in accordance with HKSAs by that same auditor.

Effective Date

2. This HKSA is effective for engagements for periods beginning on or after 15 December 2009.

Objectives

3. The objectives of the auditor are:

   (a) To determine whether it is appropriate to accept the engagement to report on summary financial statements; and

   (b) If engaged to report on summary financial statements:

      (i) To form an opinion on the summary financial statements based on an evaluation of the conclusions drawn from the evidence obtained; and

      (ii) To express clearly that opinion through a written report that also describes the basis for that opinion.

Definitions

4. For purposes of this HKSA, the following terms have the meanings attributed below:

   (a) Applied criteria – The criteria applied by management in the preparation of the summary financial statements.

   (b) Audited financial statements – Financial statements [1] audited by the auditor in accordance with HKSAs, and from which the summary financial statements are derived.

   (c) Summary financial statements – Historical financial information that is derived from financial statements but that contains less detail than the financial statements, while still providing a structured representation consistent with that provided by the financial statements of the entity's economic resources or obligations at a point in time or the changes therein for a period of time. [2] Different jurisdictions may use different terminology to describe such historical financial information.[2a]

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[1] HKSA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Hong Kong Standards on Auditing," paragraph 13(f), defines the term "financial statements."

[2] HKSA 200, paragraph 13(f).

[2a] In Hong Kong, the Companies Ordinance permits a company incorporated in Hong Kong (other than those falling within the reporting exemption under Division 2 of Part 9) to send to every member of the company a summary financial report in place of the reporting documents, including a full set of the annual financial statements, under section 441 of the Companies Ordinance. The form and contents of a summary financial report are set out in sections 3 to 6 of the Companies (Summary Financial Reports) Regulation (Cap. 622E). Refer to Appendix 2 for details.

Requirements

Engagement Acceptance

5. The auditor shall accept an engagement to report on summary financial statements in accordance with this HKSA only when the auditor has been engaged to conduct an audit in accordance with HKSAs of the financial statements from which the summary financial statements are derived.[2b] (Ref: Para. A1)

6. Before accepting an engagement to report on summary financial statements, the auditor shall: (Ref: Para. A2)

   (a) Determine whether the applied criteria are acceptable; (Ref: Para. A3-A7)

   (b) Obtain the agreement of management that it acknowledges and understands its responsibility:

      (i) For the preparation of the summary financial statements in accordance with the applied criteria;

      (ii) To make the audited financial statements available to the intended users of the summary financial statements without undue difficulty [2c] (or, if law or regulation provides that the audited financial statements need not be made available to the intended users of the summary financial statements and establishes the criteria for the preparation of the summary financial statements, to describe that law or regulation in the summary financial statements); and

      (iii) To include the auditor's report on the summary financial statements in any document that contains the summary financial statements and that indicates that the auditor has reported on them.

   (c) Agree with management the form of opinion to be expressed on the summary financial statements (see paragraphs 9-11).

7. If the auditor concludes that the applied criteria are unacceptable or is unable to obtain the agreement of management set out in paragraph 6(b), the auditor shall not accept the engagement to report on the summary financial statements, unless required by law or regulation to do so. An engagement conducted in accordance with such law or regulation does not comply with this HKSA. Accordingly, the auditor's report on the summary financial statements shall not indicate that the engagement was conducted in accordance with this HKSA. The auditor shall include appropriate reference to this fact in the terms of the engagement. The auditor shall also determine the effect that this may have on the engagement to audit the financial statements from which the summary financial statements are derived.

Nature of Procedures

8. The auditor shall perform the following procedures, and any other procedures that the auditor may consider necessary, as the basis for the auditor's opinion on the summary financial statements:

[2b] For reporting under footnote 2a, when planning the audit of the annual financial statements of a company, the auditor ascertains whether a summary financial report will be prepared and whether the other information will be issued to accompany the summary financial report. For definitions of "annual financial statements" and "other information", refer to paragraph 10 in Appendix 2.

[2c] For reporting under footnote 2a, section 5(5) of the Companies (Summary Financial Reports) Regulation as set out in Appendix 3 is also applicable.

(a) Evaluate whether the summary financial statements adequately disclose their summarized nature and identify the audited financial statements.

(b) When summary financial statements are not accompanied by the audited financial statements, evaluate whether they describe clearly:

(i) From whom or where the audited financial statements are available; or

(ii) The law or regulation that specifies that the audited financial statements need not be made available to the intended users of the summary financial statements and establishes the criteria for the preparation of the summary financial statements.

(c) Evaluate whether the summary financial statements adequately disclose the applied criteria.

(d) Compare the summary financial statements with the related information in the audited financial statements to determine whether the summary financial statements agree with or can be recalculated from the related information in the audited financial statements.

(e) Evaluate whether the summary financial statements are prepared in accordance with the applied criteria.

(f) Evaluate, in view of the purpose of the summary financial statements, whether the summary financial statements contain the information necessary, and are at an appropriate level of aggregation, so as not to be misleading in the circumstances.

(g) Evaluate whether the audited financial statements are available to the intended users of the summary financial statements without undue difficulty, unless law or regulation provides that they need not be made available and establishes the criteria for the preparation of the summary financial statements. (Ref: Para. A8)

Form of Opinion

9. When the auditor has concluded that an unmodified opinion on the summary financial statements is appropriate, the auditor's opinion shall, unless otherwise required by law or regulation [2d], use one of the following phrases: (Ref: Para. A9)

(a) The summary financial statements are consistent, in all material respects, with the audited financial statements, in accordance with [the applied criteria]; or

(b) The summary financial statements are a fair summary of the audited financial statements, in accordance with [the applied criteria].

10. If law or regulation prescribes the wording of the opinion on summary financial statements in terms that are different from those described in paragraph 9, the auditor shall:

(a) Apply the procedures described in paragraph 8 and any further procedures necessary to enable the auditor to express the prescribed opinion; and

(b) Evaluate whether users of the summary financial statements might misunderstand the auditor's opinion on the summary financial statements and, if so, whether additional

[2d] For reporting under footnote 2a, refer to paragraph 11 in Appendix 2.

explanation in the auditor's report on the summary financial statements can mitigate possible misunderstanding.

11. If, in the case of paragraph 10(b), the auditor concludes that additional explanation in the auditor's report on the summary financial statements cannot mitigate possible misunderstanding, the auditor shall not accept the engagement, unless required by law or regulation to do so. An engagement conducted in accordance with such law or regulation does not comply with this HKSA. Accordingly, the auditor's report on the summary financial statements shall not indicate that the engagement was conducted in accordance with this HKSA.

Timing of Work [2e] and Events Subsequent to the Date of the Auditor's Report on the Audited Financial Statements

12. The auditor's report on the summary financial statements may be dated later than the date of the auditor's report on the audited financial statements. In such cases, the auditor's report on the summary financial statements shall state that the summary financial statements and audited financial statements do not reflect the effects of events that occurred subsequent to the date of the auditor's report on the audited financial statements that may require adjustment of, or disclosure in, the audited financial statements. (Ref: Para. A10)

13. The auditor may become aware of facts that existed at the date of the auditor's report on the audited financial statements, but of which the auditor previously was unaware. In such cases, the auditor shall not issue the auditor's report on the summary financial statements until the auditor's consideration of such facts in relation to the audited financial statements in accordance with HKSA 560 [3] has been completed.

Auditor's Report on Summary Financial Statements

Elements of the Auditor's Report

14. The auditor's report on summary financial statements shall include the following elements:[4] (Ref: Para. A15)

    (a) A title clearly indicating it as the report of an independent auditor. (Ref: Para. A11)

    (b) An addressee. (Ref: Para. A12)

    (c) An introductory paragraph that:

        (i) Identifies the summary financial statements on which the auditor is reporting, including the title of each statement included in the summary financial statements; (Ref: Para. A13)

        (ii) Identifies the audited financial statements;

[2e] For reporting under footnote 2a, the auditor normally carries out his/ her work on the summary financial report at the same time as completing the annual audit rather than after its completion, so that the auditor's report on the summary report and the auditor's report on the annual financial statements can be issued at the same time. The auditor therefore encourages the directors to take this into account when they are planning the timetable for the preparation of the annual financial statements.

[3] HKSA 560, "Subsequent Events."

[4] Paragraphs 17-18, which deal with circumstances where the auditor's report on the audited financial statements has been modified, require additional elements to those listed in this paragraph.

(iii) Refers to the auditor's report on the audited financial statements, the date of that report, and, subject to paragraphs 17-18, the fact that an unmodified opinion is expressed on the audited financial statements;

(iv) If the date of the auditor's report on the summary financial statements is later than the date of the auditor's report on the audited financial statements, states that the summary financial statements and the audited financial statements do not reflect the effects of events that occurred subsequent to the date of the auditor's report on the audited financial statements; and

(v) A statement indicating that the summary financial statements do not contain all the disclosures required by the financial reporting framework applied in the preparation of the audited financial statements, and that reading the summary financial statements is not a substitute for reading the audited financial statements.

(d) A description of management's[5] responsibility for the summary financial statements, explaining that management[6] is responsible for the preparation of the summary financial statements in accordance with the applied criteria.

(e) A statement that the auditor is responsible for expressing an opinion on the summary financial statements based on the procedures required by this HKSA.

(f) A paragraph clearly expressing an opinion (see paragraphs 9-11).

(g) The auditor's signature.

(h) The date of the auditor's report. (Ref: Para. A14)

(i) The auditor's address.

15. If the addressee of the summary financial statements is not the same as the addressee of the auditor's report on the audited financial statements, the auditor shall evaluate the appropriateness of using a different addressee. (Ref: Para. A12)

16. The auditor shall date the auditor's report on the summary financial statements no earlier than: (Ref: Para. A14)

(a) The date on which the auditor has obtained sufficient appropriate evidence on which to base the opinion, including evidence that the summary financial statements have been prepared and those with the recognized authority have asserted that they have taken responsibility for them;[6a] and

(b) The date of the auditor's report on the audited financial statements.

[5] Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

[6] Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

[6a] For reporting under footnote 2a, since the auditor's responsibility is to report on the summary financial report as prepared by the directors, the auditor would not date the auditor's report on the summary financial report earlier than the date on which the summary financial report is approved by the directors.

Modifications to the Opinion, Emphasis of Matter Paragraph or Other Matter Paragraph in the Auditor's Report on the Audited Financial Statements (Ref: Para. A15)[6b]

17. When the auditor's report on the audited financial statements contains a qualified opinion, an Emphasis of Matter paragraph, or an Other Matter paragraph, but the auditor is satisfied that the summary financial statements are consistent, in all material respects, with or are a fair summary of the audited financial statements, in accordance with the applied criteria, the auditor's report on the summary financial statements shall, in addition to the elements in paragraph 14:

    (a) State that the auditor's report on the audited financial statements contains a qualified opinion, an Emphasis of Matter paragraph, or an Other Matter paragraph; and

    (b) Describe:

        (i) The basis for the qualified opinion on the audited financial statements, and that qualified opinion; or the Emphasis of Matter or the Other Matter paragraph in the auditor's report on the audited financial statements; and

        (ii) The effect thereof on the summary financial statements, if any.

18. When the auditor's report on the audited financial statements contains an adverse opinion or a disclaimer of opinion, the auditor's report on the summary financial statements shall, in addition to the elements in paragraph 14:

    (a) State that the auditor's report on the audited financial statements contains an adverse opinion or disclaimer of opinion;

    (b) Describe the basis for that adverse opinion or disclaimer of opinion; and

    (c) State that, as a result of the adverse opinion or disclaimer of opinion, it is inappropriate to express an opinion on the summary financial statements.

Modified Opinion on the Summary Financial Statements [6c]

19. If the summary financial statements are not consistent, in all material respects, with or are not a fair summary of the audited financial statements, in accordance with the applied criteria, and management does not agree to make the necessary changes, the auditor shall express an adverse opinion on the summary financial statements. (Ref: Para. A15)

Restriction on Distribution or Use or Alerting Readers to the Basis of Accounting

20. When distribution or use of the auditor's report on the audited financial statements is restricted, or the auditor's report on the audited financial statements alerts readers that the audited financial statements are prepared in accordance with a special purpose framework, the auditor shall include a similar restriction or alert in the auditor's report on the summary financial statements.

[6b] Section 4(1) of the Companies (Summary Financial Reports) Regulation requires that a summary financial report of a company must contain a statement from the company's auditor as to whether the auditor's report for that financial year is qualified or otherwise modified, or includes a reference to any matter to which the auditor drew attention by way of emphasis without qualifying the report; and if the auditor's report is qualified or otherwise modified, set out the full auditor's report and any further material necessary for the understanding of the qualification or other modification. Sections 4(2) – (4) further set out different situations of modified auditor's report. Refer to Illustration 6 in Appendix 1, paragraphs 15 and 16 in Appendix 2, and section 4 in Appendix 3 for details.

[6c] For reporting under footnote 2a, refer to paragraphs 11,13 and 16 in Appendix 2.

Comparatives

21. If the audited financial statements contain comparatives, but the summary financial statements do not, the auditor shall determine whether such omission is reasonable in the circumstances of the engagement. The auditor shall determine the effect of an unreasonable omission on the auditor's report on the summary financial statements. (Ref: Para. A16)

22. If the summary financial statements contain comparatives that were reported on by another auditor, the auditor's report on the summary financial statements shall also contain the matters that HKSA 710 requires the auditor to include in the auditor's report on the audited financial statements.[7] (Ref: Para. A17)

Unaudited Supplementary Information Presented with Summary Financial Statements

23. The auditor shall evaluate whether any unaudited supplementary information presented with the summary financial statements is clearly differentiated from the summary financial statements. If the auditor concludes that the entity's presentation of the unaudited supplementary information is not clearly differentiated from the summary financial statements, the auditor shall ask management to change the presentation of the unaudited supplementary information. If management refuses to do so, the auditor shall explain in the auditor's report on the summary financial statements that such information is not covered by that report. (Ref: Para. A18)

Other Information in Documents Containing Summary Financial Statements

24. The auditor shall read the other information included in a document containing the summary financial statements and related auditor's report to consider whether there is~~identify~~ a material inconsistency~~ies~~ between the other information and~~, if any, with~~ the summary financial statements. If~~, on reading the other information,~~ the auditor identifies a material inconsistency, the auditor shall determine whether the summary financial statements or the other information needs to be revised. If~~, on reading the other information,~~ the auditor becomes aware ~~of an apparent material misstatement of fact~~that the other information needs to be revised, the auditor shall discuss the matter with management. (Ref: Para. A19)

Auditor Association

25. If the auditor becomes aware that the entity plans to state that the auditor has reported on summary financial statements in a document containing the summary financial statements, but does not plan to include the related auditor's report, the auditor shall request management to include the auditor's report in the document. If management does not do so, the auditor shall determine and carry out other appropriate actions designed to prevent management from inappropriately associating the auditor with the summary financial statements in that document. (Ref: Para. A20)

26. The auditor may be engaged to report on the financial statements of an entity, while not engaged to report on the summary financial statements. If, in this case, the auditor becomes aware that the entity plans to make a statement in a document that refers to the auditor and the fact that summary financial statements are derived from the financial statements audited by the auditor, the auditor shall be satisfied that:

    (a) The reference to the auditor is made in the context of the auditor's report on the audited financial statements; and

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[7] HKSA 710, "Comparative Information—Corresponding Figures and Comparative Financial Statements."

(b) The statement does not give the impression that the auditor has reported on the summary financial statements.

If (a) or (b) are not met, the auditor shall request management to change the statement to meet them, or not to refer to the auditor in the document. Alternatively, the entity may engage the auditor to report on the summary financial statements and include the related auditor's report in the document. If management does not change the statement, delete the reference to the auditor, or include an auditor's report on the summary financial statements in the document containing the summary financial statements, the auditor shall advise management that the auditor disagrees with the reference to the auditor, and the auditor shall determine and carry out other appropriate actions designed to prevent management from inappropriately referring to the auditor. (Ref: Para. A20)

Conformity and Compliance with International Standards on Auditing

27. As of October 2009 (date of issue), this HKSA conforms with International Standard on Auditing (ISA) 810 "Engagements to Report on Summary Financial Statements". Compliance with the requirements of this HKSA ensures compliance with ISA 810.

28. Additional local explanations and guidance are provided in footnotes 2a, 2b, 2c, 2d, 2e, 6a, 6b, 6c and the Appendices 1, 2 and 3.

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Application and Other Explanatory Material

Engagement Acceptance (Ref: Para. 5-6)

A1. The audit of the financial statements from which the summary financial statements are derived provides the auditor with the necessary knowledge to discharge the auditor's responsibilities in relation to the summary financial statements in accordance with this HKSA. Application of this HKSA will not provide sufficient appropriate evidence on which to base the opinion on the summary financial statements if the auditor has not also audited the financial statements from which the summary financial statements are derived.

A2. Management's agreement with the matters described in paragraph 6 may be evidenced by its written acceptance of the terms of the engagement.

Criteria (Ref: Para. 6(a))

A3. The preparation of summary financial statements requires management to determine the information that needs to be reflected in the summary financial statements so that they are consistent, in all material respects, with or represent a fair summary of the audited financial statements. Because summary financial statements by their nature contain aggregated information and limited disclosure, there is an increased risk that they may not contain the information necessary so as not to be misleading in the circumstances. This risk increases when established criteria for the preparation of summary financial statements do not exist.

A4. Factors that may affect the auditor's determination of the acceptability of the applied criteria include:

- The nature of the entity;
- The purpose of the summary financial statements;
- The information needs of the intended users of the summary financial statements; and

- Whether the applied criteria will result in summary financial statements that are not misleading in the circumstances.

A5. The criteria for the preparation of summary financial statements may be established by an authorized or recognized standards setting organization or by law or regulation. Similar to the case of financial statements, as explained in HKSA 210,[8] in many such cases, the auditor may presume that such criteria are acceptable.

A6. Where established criteria for the preparation of summary financial statements do not exist, criteria may be developed by management, for example, based on practice in a particular industry. Criteria that are acceptable in the circumstances will result in summary financial statements that:

(a) Adequately disclose their summarized nature and identify the audited financial statements;

(b) Clearly describe from whom or where the audited financial statements are available or, if law or regulation provides that the audited financial statements need not be made available to the intended users of the summary financial statements and establishes the criteria for the preparation of the summary financial statements, that law or regulation;

(c) Adequately disclose the applied criteria;

(d) Agree with or can be recalculated from the related information in the audited financial statements; and

(e) In view of the purpose of the summary financial statements, contain the information necessary, and are at an appropriate level of aggregation, so as not to be misleading in the circumstances.

A7. Adequate disclosure of the summarized nature of the summary financial statements and the identity of the audited financial statements, as referred to in paragraph A6(a), may, for example, be provided by a title such as “Summary Financial Statements Prepared from the Audited Financial Statements for the Year Ended 31 December 20X1.”

Evaluating the Availability of the Audited Financial Statements (Ref: Para. 8(g))

A8. The auditor’s evaluation whether the audited financial statements are available to the intended users of the summary financial statements without undue difficulty is affected by factors such as whether:

- The summary financial statements describe clearly from whom or where the audited financial statements are available;
- The audited financial statements are on public record; or
- Management has established a process by which the intended users of the summary financial statements can obtain ready access to the audited financial statements.

Form of Opinion (Ref: Para. 9)

A9. A conclusion, based on an evaluation of the evidence obtained by performing the procedures in paragraph 8, that an unmodified opinion on the summary financial statements is appropriate enables the auditor to express an opinion containing one of the phrases in

[8] HKSA 210, “Agreeing the Terms of Audit Engagements,” paragraphs A3 and A8-A9.

paragraph 9. The auditor's decision as to which of the phrases to use may be affected by generally accepted practice in the particular jurisdiction.

Timing of Work and Events Subsequent to the Date of the Auditor's Report on the Audited Financial Statements (Ref: Para. 12)

A10. The procedures described in paragraph 8 are often performed during or immediately after the audit of the financial statements. When the auditor reports on the summary financial statements after the completion of the audit of the financial statements, the auditor is not required to obtain additional audit evidence on the audited financial statements, or report on the effects of events that occurred subsequent to the date of the auditor's report on the audited financial statements since the summary financial statements are derived from the audited financial statements and do not update them.

Auditor's Report on Summary Financial Statements

Elements of the Auditor's Report

Title (Ref: Para. 14(a))

A11. A title indicating the report is the report of an independent auditor, for example, "Report of the Independent Auditor," affirms that the auditor has met all of the relevant ethical requirements regarding independence. This distinguishes the report of the independent auditor from reports issued by others.

Addressee (Ref: Para. 14(b), 15)

A12. Factors that may affect the auditor's evaluation of the appropriateness of the addressee of the summary financial statements include the terms of the engagement, the nature of the entity, and the purpose of the summary financial statements.

Introductory Paragraph (Ref: Para. 14(c)(i))

A13. When the auditor is aware that the summary financial statements will be included in a document that contains other information, the auditor may consider, if the form of presentation allows, identifying the page numbers on which the summary financial statements are presented. This helps readers to identify the summary financial statements to which the auditor's report relates.

Date of the Auditor's Report (Ref: Para. 14(h), 16)

A14. The person or persons with recognized authority to conclude that the summary financial statements have been prepared and take responsibility for them depend on the terms of the engagement, the nature of the entity, and the purpose of the summary financial statements.

Illustrations (Ref: Para.14, 17-18,19)

A15. The Appendix to this HKSA contains illustrations of auditors' reports on summary financial statements that:

(a) Contain unmodified opinions;

(b) Are derived from audited financial statements on which the auditor issued modified opinions; and

(c) Contain a modified opinion.

Comparatives (Ref: Para. 21-22)

A16. If the audited financial statements contain comparatives, there is a presumption that the summary financial statements also would contain comparatives. Comparatives in the audited financial statements may be regarded as corresponding figures or as comparative financial information. HKSA 710 describes how this difference affects the auditor's report on the financial statements, including, in particular, reference to other auditors who audited the financial statements for the prior period.

A17. Circumstances that may affect the auditor's determination whether an omission of comparatives is reasonable include the nature and objective of the summary financial statements, the applied criteria, and the information needs of the intended users of the summary financial statements.

Unaudited Supplementary Information Presented with Summary Financial Statements (Ref: Para. 23)

A18. HKSA 700 [9] contains requirements and guidance to be applied when unaudited supplementary information is presented with audited financial statements that, adapted as necessary in the circumstances, may be helpful in applying the requirement in paragraph 23.

Other Information in Documents Containing Summary Financial Statements (Ref: Para. 24)

A19. HKSA 720 (Revised)[10] contains requirements and guidance ~~relating~~ regarding the auditor's responsibilities relating to ~~reading~~ other information in a financial statement audit engagement~~included in a document containing the audited financial statements and related auditor's report, and responding to material inconsistencies and material misstatements of fact~~. Adapted as necessary in the circumstances, they may be helpful in applying the requirement in paragraph 24.

Auditor Association (Ref: Para. 25-26)

A20. Other appropriate actions the auditor may take when management does not take the requested action may include informing the intended users and other known third-party users of the inappropriate reference to the auditor. The auditor's course of action depends on the auditor's legal rights and obligations. Consequently, the auditor may consider it appropriate to seek legal advice.

[9] HKSA 700, ~~"~~*Forming an Opinion and Reporting on Financial Statements*,~~"~~ paragraphs 46-47.

[10] HKSA 720 (Revised), ~~"~~*The Auditor's Responsibilities Relating to Other Information* ~~in Documents Containing Audited Financial Statements."~~

Appendix 1

(Ref: Para. A15)

Illustrations of Reports on Summary Financial Statements

- Illustration 1: An auditor's report on summary financial report prepared in accordance with section 439 of the Hong Kong Companies Ordinance and complies with the requirements of Part 2 of the Hong Kong Companies (Summary Financial Reports) Regulation. An unmodified opinion is expressed on the audited financial statements. The auditor's report on the summary financial report is dated later than the date of the auditor's report on the financial statements from which summary financial statements are derived.

- Illustration 2: An auditor's report on summary financial statements prepared in accordance with criteria developed by management and adequately disclosed in the summary financial statements. The auditor has determined that the applied criteria are acceptable in the circumstances. An unmodified opinion is expressed on the audited financial statements.

- Illustration 3: An auditor's report on summary financial statements prepared in accordance with criteria developed by management and adequately disclosed in the summary financial statements. The auditor has determined that the applied criteria are acceptable in the circumstances. A qualified opinion is expressed on the audited financial statements.

- Illustration 4: An auditor's report on summary financial statements prepared in accordance with criteria developed by management and adequately disclosed in the summary financial statements. The auditor has determined that the applied criteria are acceptable in the circumstances. An adverse opinion is expressed on the audited financial statements.

- Illustration 5: An auditor's report on summary financial report prepared in accordance with section 439 of the Hong Kong Companies Ordinance and complies with the requirements of Part 2 of the Hong Kong Companies (Summary Financial Reports) Regulation. An unmodified opinion is expressed on the audited financial statements. The auditor concludes that it is not possible to express an unmodified opinion on the summary financial report.

- Illustration 6: An auditor's report on summary financial report prepared in accordance with section 439 of the Hong Kong Companies Ordinance and complies with the requirements of Part 2 of the Hong Kong Companies (Summary Financial Reports) Regulation. A qualified opinion is expressed on the audited financial statements.

<u>Illustration 1:</u>

Circumstances include the following:

- **An unmodified opinion is expressed on the audited financial statements.**
- **The summary financial report is prepared in accordance with section 439 of the Hong Kong Companies Ordinance and complies with the requirements of Part 2 of the Hong Kong Companies (Summary Financial Reports) Regulation.**
- **The auditor's report on the summary financial statements is dated later than the date of the auditor's report on the financial statements from which the summary financial statements are derived.**

REPORT OF THE INDEPENDENT AUDITOR ON THE SUMMARY FINANCIAL REPORT

TO THE MEMBERS OF ABC LIMITED

(incorporated in [Hong Kong] with limited liability)[1a]

The summary financial report of ABC Limited ("the Company") set out on pages … to …, includes the [summary financial statements] of the Company for the year ended 31 December 20X1. The [summary financial statements] of the Company set out on pages … to …which comprise the summary statement of financial position[1b] as at 31 December 20X1, the summary statement of comprehensive income[1b] [,][and summary income statement][1c] [, summary statement of changes in equity and summary statement of cash flows] for the year then ended, and related notes are derived from the audited financial statements of the Company for the year ended 31 December 20X1. We expressed an unmodified audit opinion on those financial statements in our report dated 15 February 20X2. Those financial statements, and the summary financial report, do not reflect the effects of events that occurred subsequent to the date of our report on those financial statements.

The [summary financial statements] do not contain all the disclosures required by Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants. Reading the [summary financial statements], therefore, is not a substitute for reading the audited financial statements of the Company.

Directors' [1] Responsibility for the Summary Financial Report

Under the Hong Kong Companies Ordinance, the directors are responsible for the preparation of a summary financial report in accordance with section 439 of the Hong Kong Companies Ordinance and the Hong Kong Companies (Summary Financial Reports) Regulation. In preparing the summary financial report, sections 3(1) and (2) of the Hong Kong Companies (Summary Financial Reports) Regulation requires that the summary financial report must contain the information derived from the annual financial statements and the auditor's report thereon and the directors' report for the year

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

1b Sections 3(3)(a) and (b) of the Hong Kong Companies (Summary Financial Reports) Regulation states that a summary financial report of a company must contain all the information and particulars included in the company's statement of financial position and statement of comprehensive income; or the company's consolidated statement of financial position and consolidated statement of comprehensive income if the company is a holding company.

1c Sections 3(3)(c) and (d) of the Hong Kong Companies (Summary Financial Reports) Regulation states that if the company's reporting documents for the financial year include a separate income statement in addition to the company's statement of comprehensive income, the summary financial report must contain all the information and particulars included in the income statement; or if the company is a holding company and its reporting documents for the financial year include a separate consolidated income statement in addition to the company's consolidated statement of comprehensive income, the summary financial report must contain all the information and particulars included in the consolidated income statement.

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

ended 31 December 20X1 and contain such information and particulars set out in sections 3(3), 5 and 6 of the Hong Kong Companies (Summary Financial Reports) Regulation, and be approved by the board of directors.

Auditor's Responsibility

Our responsibility is to express an opinion on the summary financial report based on our procedures, which were conducted in accordance with Hong Kong Standard on Auditing 810, "Engagements to Report on Summary Financial Statements" issued by the Hong Kong Institute of Certified Public Accountants. We are also required to state whether the auditor's report on the annual financial statements for the year ended 31 December 20X1 is qualified or otherwise modified.

Opinion

In our opinion, the summary financial report:

a. is consistent with the annual financial statements and the auditor's report thereon and the directors' report of the Company for the year ended 31 December 20X1 from which it is derived; and

b. complies with the requirements of Part 2 of the Hong Kong Companies (Summary Financial Reports) Regulation.

XYZ & Co.

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

[Auditor's address]

[Date of the auditor's report]

Illustration 2:

Circumstances include the following:

- **An unmodified opinion is expressed on the audited financial statements.**
- **Criteria are developed by management and adequately disclosed in Note X. The auditor has determined that the criteria are acceptable in the circumstances.**

REPORT OF THE INDEPENDENT AUDITOR ON THE SUMMARY FINANCIAL STATEMENTS

TO THE MEMBERS OF ABC LIMITED

(incorporated in [Hong Kong] with limited liability)[1d]

The summary financial statements of ABC Limited ("the Company") set out on pages … to …, which comprise the summary statement of financial position as at 31 December 20X1, the summary statement of comprehensive income, summary statement of changes in equity and summary statement of cash flows for the year then ended, and related notes, are derived from the audited financial statements of the Company for the year ended 31 December 20X1. We expressed an unmodified audit opinion on those financial statements in our report dated 15 February 20X2.[2]

The summary financial statements do not contain all the disclosures required by [describe financial reporting framework applied in the preparation of the audited financial statements of ABC Limited for example, the Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants.] Reading the summary financial statements, therefore, is not a substitute for reading the audited financial statements of the Company.

Management's [3] Responsibility for the Summary Financial Statements

Management is responsible for the preparation of a summary of the audited financial statements on the basis described in Note X.

Auditor's Responsibility

Our responsibility is to express an opinion on the summary financial statements based on our procedures, which were conducted in accordance with Hong Kong Standard on Auditing 810, "Engagements to Report on Summary Financial Statements" issued by the Hong Kong Institute of Certified Public Accountants.

Opinion

In our opinion, the summary financial statements derived from the audited financial statements of the Company for the year ended 31 December 20X1 are consistent, in all material respects, with (or *a fair summary of*) those financial statements, on the basis described in Note X.

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

2 When the auditor's report on the summary financial statements is dated later than the date of the auditor's report on the audited financial statements from which it is derived, the following sentence is added to this paragraph: "Those financial statements, and the summary financial statements, do not reflect the effects of events that occurred subsequent to the date of our report on those financial statements."

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

XYZ & Co.

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

[Auditor's address]

[Date of the auditor's report]

Illustration 3:

Circumstances include the following:

- **A qualified opinion is expressed on the audited financial statements.**
- **Criteria are developed by management and adequately disclosed in Note X. The auditor has determined that the criteria are acceptable in the circumstances.**

REPORT OF THE INDEPENDENT AUDITOR ON THE SUMMARY FINANCIAL STATEMENTS

TO THE MEMBERS OF ABC LIMITED

(incorporated in [Hong Kong] with limited liability)[3a]

The summary financial statements of ABC Limited ("the Company") set out on pages … to …, which comprise the summary statement of financial position as at 31 December 20X1, the summary statement of comprehensive income, summary statement of changes in equity and summary statement of cash flows for the year then ended, and related notes, are derived from the audited financial statements of the Company for the year ended 31 December 20X1.[4] We expressed a qualified audit opinion on those financial statements in our report dated 15 February 20X2 (see below).

The summary financial statements do not contain all the disclosures required by [describe financial reporting framework applied in the preparation of the audited financial statements of ABC Limited for example, the Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants.] Reading the summary financial statements, therefore, is not a substitute for reading the audited financial statements of the Company.

Management's [5] Responsibility for the Summary Financial Statements

Management is responsible for the preparation of a summary of the audited financial statements on the basis described in Note X.

Auditor's Responsibility

Our responsibility is to express an opinion on the summary financial statements based on our procedures, which were conducted in accordance with Hong Kong Standard on Auditing 810, "Engagements to Report on Summary Financial Statements" issued by the Hong Kong Institute of Certified Public Accountants.

Opinion

In our opinion, the summary financial statements derived from the audited financial statements of the Company for the year ended 31 December 20X1 are consistent, in all material respects, with (or *a fair summary of*) those financial statements, on the basis described in Note X. However, the summary financial statements are misstated to the equivalent extent as the audited financial statements of the Company for the year ended 31 December 20X1.

[3a] In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

[4] When the auditor's report on the summary financial statements is dated later than the date of the auditor's report on the audited financial statements from which it is derived, the following sentence is added to this paragraph: "Those financial statements, and the summary financial statements, do not reflect the effects of events that occurred subsequent to the date of our report on those financial statements."

[5] Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

The misstatement of the audited financial statements is described in our qualified audit opinion in our report dated 15 February 20X2. Our qualified audit opinion is based on the fact that the Company's inventories are carried in the statement of financial position in those financial statements at xxx. Management has not stated the inventories at the lower of cost and net realizable value but has stated them solely at cost, which constitutes a departure from Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants. The Company's records indicate that had management stated the inventories at the lower of cost and net realizable value, an amount of xxx would have been required to write the inventories down to their net realizable value. Accordingly, cost of sales would have been increased by xxx, and income tax, net income and shareholders' equity would have been reduced by xxx, xxx and xxx, respectively. Our qualified audit opinion states that, except for the effects of the described matter, those financial statements present fairly, in all material respects, (or *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 issued by the Hong Kong Institute of Certified Public Accountants.

XYZ & Co.

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

[Auditor's address]

[Date of the auditor's report]

Illustration 4:

Circumstances include the following:

- **An adverse opinion is expressed on the audited financial statements.**
- **Criteria are developed by management and adequately disclosed in Note X. The auditor has determined that the criteria are acceptable in the circumstances.**

REPORT OF THE INDEPENDENT AUDITOR ON THE SUMMARY FINANCIAL STATEMENTS

TO THE MEMBERS OF ABC LIMITED

(incorporated in [Hong Kong] with limited liability)[5a]

The summary financial statements of ABC Limited ("the Company") set out on pages … to …, which comprise the summary statement of financial position as at 31 December 20X1, the summary statement of comprehensive income, summary statement of changes in equity and summary statement of cash flows for the year then ended, and related notes, are derived from the audited financial statements of the Company for the year ended 31 December 20X1.[6]

The summary financial statements do not contain all the disclosures required by [describe financial reporting framework applied in the preparation of the audited financial statements of ABC Limited for example, the Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants.] Reading the summary financial statements, therefore, is not a substitute for reading the audited financial statements of the Company.

Management's [7] Responsibility for the Summary Financial Statements

Management is responsible for the preparation of a summary of the audited financial statements on the basis described in Note X.

Auditor's Responsibility

Our responsibility is to express an opinion on the summary financial statements based on our procedures, which were conducted in accordance with Hong Kong Standard on Auditing 810, "Engagements to Report on Summary Financial Statements" issued by the Hong Kong Institute of Certified Public Accountants.

Denial of Opinion

In our report dated 15 February 20X2, we expressed an adverse audit opinion on the financial statements of the Company for the year ended 31 December 20X1. The basis for our adverse audit opinion was [describe basis for adverse audit opinion]. Our adverse audit opinion stated that [describe adverse audit opinion].

Because of the significance of the matter discussed above, it is inappropriate to express an opinion on the summary financial statements of the Company for the year ended 31 December 20X1.

5a In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

6 When the auditor's report on the summary financial statements is dated later than the date of the auditor's report on the audited financial statements from which it is derived, the following sentence is added to this paragraph: "Those financial statements, and the summary financial statements, do not reflect the effects of events that occurred subsequent to the date of our report on those financial statements."

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

XYZ & Co.

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

[Auditor's address]

[Date of the auditor's report]

Illustration 5:

Circumstances include the following:

- **An unmodified opinion is expressed on the audited financial statements.**
- **The summary financial report is prepared in accordance with section 439 of the Hong Kong Companies Ordinance and complies with the requirements of Part 2 of the Hong Kong Companies (Summary Financial Reports) Regulation.**
- **The auditor concludes that it is not possible to express an unmodified opinion on the summary financial statements.**

REPORT OF THE INDEPENDENT AUDITOR ON THE SUMMARY FINANCIAL REPORT

TO THE MEMBERS OF ABC LIMITED

(incorporated in [Hong Kong] with limited liability)[7a]

The summary financial report of ABC Limited ("the Company") set out on pages … to …, includes the [summary financial statements] of the Company for the year ended 31 December 20X1. The [summary financial statements] of the Company set out on pages … to …which comprise the summary statement of financial position[7b] as at 31 December 20X1, the summary statement of comprehensive income[7b] [,][and summary income statement][7c] [, summary statement of changes in equity and summary statement of cash flows] for the year then ended, and related notes are derived from the audited financial statements of the Company for the year ended 31 December 20X1. We expressed an unmodified audit opinion on those financial statements in our report dated 15 February 20X2.[8]

The [summary financial statements] do not contain all the disclosures required by the Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants. Reading the [summary financial statements], therefore, is not a substitute for reading the audited financial statements of the Company.

Directors' [9] Responsibility for the Summary Financial Report

Under the Hong Kong Companies Ordinance, the directors are responsible for the preparation of a summary financial report in accordance with section 439 of the Hong Kong Companies Ordinance and the Hong Kong Companies (Summary Financial Reports) Regulation. In preparing the summary

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7a In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

7b Sections 3(3)(a) and (b) of the Hong Kong Companies (Summary Financial Reports) Regulation states that a summary financial report of a company must contain all the information and particulars included in the company's statement of financial position and statement of comprehensive income; or the company's consolidated statement of financial position and consolidated statement of comprehensive income if the company is a holding company.

7c Sections 3(3)(c) and (d) of the Hong Kong Companies (Summary Financial Reports) Regulation states that if the company's reporting documents for the financial year include a separate income statement in addition to the company's statement of comprehensive income, the summary financial report must contain all the information and particulars included in the income statement; or if the company is a holding company and its reporting documents for the financial year include a separate consolidated income statement in addition to the company's consolidated statement of comprehensive income, the summary financial report must contain all the information and particulars included in the consolidated income statement.

8 When the auditor's report on the summary financial report is dated later than the date of the auditor's report on the audited financial statements from which it is derived, the following sentence is added to this paragraph: "Those financial statements, and the summary financial report, do not reflect the effects of events that occurred subsequent to the date of our report on those financial statements."

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

financial report, section 3(1) and (2) of the Hong Kong Companies (Summary Financial Reports) Regulation requires that the summary financial report must contain the information derived from the annual financial statements and the auditor's report thereon and the Directors' report for the year ended 31 December 20X1, and contain such information and particulars set out in sections 3(3), 5 and 6 of the Hong Kong Companies (Summary Financial Reports) Regulation, and be approved by the board of directors.

Auditor's Responsibility

Our responsibility is to express an opinion on the summary financial report based on our procedures, which were conducted in accordance with Hong Kong Standard on Auditing 810, "Engagements to Report on Summary Financial Statements" issued by the Hong Kong Institute of Certified Public Accountants. We are also required to state whether the auditor's report on the annual financial statements for the year ended 31 December 20X1 is qualified or otherwise modified.

Basis for Adverse Opinion

[Describe matter that caused the summary financial report not to be consistent, in all material respects, with (or *a fair summary of*) the audited financial statements, in accordance with section 439 of the Hong Kong Companies Ordinance and Part 2 of the Hong Kong Companies (Summary Financial Reports) Regulation.]

Adverse Opinion

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion paragraph, the summary financial report referred to above:

a. is not consistent with the annual financial statements and the auditor's report thereon and the directors' report of the Company for the year ended 31 December 20X1 from which it is derived; and
b. does not comply with the requirements of Part 2 of the Hong Kong Companies (Summary Financial Reports) Regulation.

XYZ & Co.

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

[Auditor's address]

[Date of the auditor's report]

Illustration 6:

Circumstances include the following:

- **A qualified opinion is expressed on the audited financial statements.**
- **The summary financial report is prepared in accordance with section 439 of the Hong Kong Companies Ordinance and complies with the requirements of Part 2 of the Hong Kong Companies (Summary Financial Reports) Regulation.**
- **The auditor's report on the summary financial statements is dated later than the date of the auditor's report on the financial statements from which the summary financial statements are derived.**

REPORT OF THE INDEPENDENT AUDITOR ON THE SUMMARY FINANCIAL REPORT

TO THE MEMBERS OF ABC LIMITED

(incorporated in [Hong Kong] with limited liability)[10]

The summary financial report of ABC Limited ("the Company") set out on pages … to …, includes the [summary financial statements] of the Company for the year ended 31 December 20X1. The [summary financial statements] of the Company set out on pages … to …which comprise the summary statement of financial position][11] as at 31 December 20X1, the summary statement of comprehensive income[11][,][and summary income statement[12]] [, summary statement of changes in equity and summary statement of cash flows] for the year then ended, and related notes are derived from the audited financial statements of the Company for the year ended 31 December 20X1. We expressed a qualified audit opinion on those financial statements in our report dated 15 February 20X2 (see below). A copy of the qualified auditor's report [and the further material necessary for the understanding of the qualification][13] [has/ have] been set out on pages … to … of the summary financial report.[14]

The [summary financial statements] do not contain all the disclosures required by the Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants. Reading the [summary financial statements], therefore, is not a substitute for reading the audited financial statements of the Company.

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

[11] Sections 3(3)(a) and (b) of the Hong Kong Companies (Summary Financial Reports) Regulation states that a summary financial report of a company must contain all the information and particulars included in the company's statement of financial position and statement of comprehensive income; or the company's consolidated statement of financial position and consolidated statement of comprehensive income if the company is a holding company.

[12] Sections 3(3)(c) and (d) of the Hong Kong Companies (Summary Financial Reports) Regulation states that if the company's reporting documents for the financial year include a separate income statement in addition to the company's statement of comprehensive income, the summary financial report must contain all the information and particulars included in the income statement; or if the company is a holding company and its reporting documents for the financial year include a separate consolidated income statement in addition to the company's consolidated statement of comprehensive income, the summary financial report must contain all the information and particulars included in the consolidated income statement.

[13] Section 4(1) of the Hong Kong Companies (Summary Financial Reports) Regulation states that a summary financial report of a company must contain a statement from the company's auditors as to whether the auditors' report for that financial year is qualified or otherwise modified, or includes a reference to any matter to which the auditor drew attention by way of emphasis without qualifying the report; and if the auditors' report is qualified or otherwise modified, set out the full auditors' report and any further material necessary for the understanding of the qualification or other modification.

[14] When the auditor's report on the summary financial report is dated later than the date of the auditor's report on the audited financial statements from which it is derived, the following sentence is added to this paragraph: "Those financial statements, and the summary financial report, do not reflect the effects of events that occurred subsequent to the date of our report on those financial statements."

Directors' [15] Responsibility for the Summary Financial Report

Under the Hong Kong Companies Ordinance, the directors are responsible for the preparation of a summary financial report in accordance with section 439 of the Hong Kong Companies Ordinance and the Hong Kong Companies (Summary Financial Reports) Regulation. In preparing the summary financial report, section 3(1) and (2) of the Hong Kong Companies (Summary Financial Reports) Regulation requires that the summary financial report must contain the information derived from the annual financial statements and the auditor's report thereon and the directors' report for the year ended 31 December 20X1, and contain such information and particulars set out in sections 3(3), 5 and 6 of the Hong Kong Companies (Summary Financial Reports) Regulation, and be approved by the board of directors.

Auditor's Responsibility

Our responsibility is to express an opinion on the summary financial report based on our procedures, which were conducted in accordance with Hong Kong Standard on Auditing 810, "Engagements to Report on Summary Financial Statements" issued by the Hong Kong Institute of Certified Public Accountants. We are also required to state whether the auditor's report on the annual financial statements for the year ended 31 December 20X1 is qualified or otherwise modified.

Opinion

In our opinion, the summary financial report:

a. is consistent with the annual financial statements and the auditor's report thereon and the directors' report of the Company for the year ended 31 December 20X1 from which it is derived; and

b. complies with the requirements of Part 2 of the Hong Kong Companies (Summary Financial Reports) Regulation.

However, we were unable to obtain sufficient appropriate audit evidence regarding an investment in a foreign associate as stated in the audited financial statements of the Company for the year ended 31 December 20X1.

This inability to obtain sufficient appropriate audit evidence is described in our qualified audit opinion in our report dated 15 February 20X2. Our qualified audit opinion is based on the fact that the Company’s investment in DEF Limited, a foreign associate acquired during the year and accounted for by the equity method, is carried at xxx on the statement of financial position as at 31 December 20X1, and the Company’s share of DEF Limited’s net income of xxx is included in the Company’s income for the year then ended. We were unable to obtain sufficient appropriate audit evidence about the carrying amount of the Company’s investment in DEF Limited as at 31 December 20X1 and the Company’s share of DEF Limited’s net income for the year because we were denied access to the financial information, management, and the auditors of DEF Limited. Consequently, we were unable to determine whether any adjustments to these amounts were necessary. Our qualified audit opinion states that, except for the effects of the described matter, those financial statements give a true and fair view of the financial position of the Company as at 31 December 20X1, and of its financial performance and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in compliance with the Hong Kong Companies Ordinance.[16]

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[15] Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

[16] Section 4(2) of the Hong Kong Companies (Summary Financial Reports) Regulation states that if the auditor's report of a company contains a statement that, in the auditor's opinion, the financial statements for a financial year of the company have not been properly prepared in compliance with the Ordinance, and in particular –

(a) a true and fair view of the financial position and financial performance of the company has not been given; or

(b) for a company that is required to prepare annual consolidated financial statements, a true and fair view of the financial position and financial performance of the company, and all the subsidiary undertakings, as a whole has not been given, [In addition, the information given in the directors' report for the year ended 31 December 20X1 is not consistent with the [summary financial statements] of the Company for the year ended 31 December 20X1 to the equivalent extent as the financial statements of the Company for the year ended 31 December 20X1. The inconsistencies are described in our report dated 15 February 20X2. [*State the details of the inconsistencies.*]][17]

In respect alone the inability to obtain sufficient appropriate audit evidence regarding an investment in a foreign associate as described above:

- we were unable to determine whether adequate accounting records had been kept; and
- we have not obtained all the information and explanations that, to the best of our knowledge and belief, are necessary and material for the purpose of the audit.[18]

XYZ & Co.

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

[Auditor's address]

[Date of the auditor's report]

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a summary financial report for that financial year must contain that statement.

17 Section 4(3) of the Hong Kong Companies (Summary Financial Reports) Regulation states that if the auditor's report of a company contains a statement that, in the auditor's opinion, the information in a director's report for a financial year is not consistent with the financial statements for the financial year, a summary financial report for that financial year must contain that statement.

18 Section 4(4) of the Hong Kong Companies (Summary Financial Reports) Regulation states that if the auditor's report for a financial year of a company contains—

(a) a statement that, in the auditor's opinion—

(i) adequate accounting records have not been kept by the company; or

(ii) the company's financial statements are not in agreement with its accounting records in any material respect;

(b) a statement that the auditor has failed to obtain all the information or explanations that, to the best of the auditor's knowledge and belief, are necessary and material for the purpose of the audit; and

(c) a statement giving the particulars that are required to be, but have not been, contained in the financial statements, as required by section 407(4) of the Ordinance,

a summary financial report for that financial year must contain those statements.

Appendix 2

(Ref: Para. 4(c))

Additional Local Guidance for Auditors to Report on Summary Financial Report

Hong Kong Companies Ordinance

1. The Hong Kong Companies Ordinance (Cap. 622) (CO) was enacted on 12 July 2013 and commenced operation on 3 March 2014. Under section 439 of the CO, the directors of a company may prepare for a financial year a financial report, in summary form, derived from the reporting documents for the financial year (a copy of which is required to be sent to every member of the company under section 430). Under section 441, the summary financial report may be sent to member instead of the reporting documents under section 430. An extract of the relevant provisions of the law on the form and contents of the summary financial report is set out in Appendix 3.

Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the Listing Rules)

2. Main Board Listing Rule 13.46 states that the issuer may send a copy of its summary financial report to a member and a holder of its listed securities in place of a copy of its annual report and accounts, provided that it complies with the relevant provisions set out in the predecessor CO and in the Companies (Summary Financial Reports of Listed Companies) Regulation or, in the case of overseas issuers, with provisions no less onerous than the aforementioned provisions for listed issuers incorporated in Hong Kong.

3. The Listing Rules (Chapter 1) define a summary financial report as one which complies with section 141CF(1) of the predecessor CO.

4. Section 141CF(1) of the predecessor CO is replaced by Section 439 of the CO with effect from 3 March 2014.

5. Companies (Summary Financial Reports of Listed Companies) Regulation is replaced by the Companies (Summary Financial Reports) Regulation with effect from 3 March 2014.

Rules Governing the Listing of Securities on the Growth Enterprise Market of The Stock Exchange of Hong Kong Limited (the GEM Listing Rules)

6. The GEM Listing Rules (Chapters 18 and 31) state that a listed issuer may send a copy of its summary financial report to a member and a holder of its listed securities in place of a copy of its annual report and accounts, provided that it complies with the relevant provisions set out in the predecessor CO and in the Companies (Summary Financial Reports of Listed Companies) Regulation or, in the case of overseas issuers, with provisions no less onerous than the aforementioned provisions for listed issuers incorporated in Hong Kong.

7. The GEM Listing Rules (Chapter 1) define a summary financial report as one which complies with section 141CF(1) of the predecessor CO.

8. Section 141CF(1) of the predecessor CO is replaced by Section 439 of the CO with effect from 3 March 2014.

9. Companies (Summary Financial Reports of Listed Companies) Regulation is replaced by the Companies (Summary Financial Reports) Regulation with effect from 3 March 2014.

Definitions

10. For the purpose of this appendix, the following definitions apply:

    (a) annual financial statements - a complete set of financial statements for a financial year, the components of which are:

    (i) statement of financial position;
    (ii) income statement / statement of profit or loss / statement of profit or loss and other comprehensive income;
    (iii) statement of changes in equity;
    (iv) statement of cash flows; and
    (v) a summary of significant accounting policies and other explanatory information; and

    (b) other information - financial and non-financial information, in addition to that legally required to be included in the summary financial report under Part 2 of the Companies (Summary Financial Reports) Regulation, which is issued by the directors to accompany the summary financial report.

Form of Opinion

11. Section 4(5) of the Companies (Summary Financial Reports) Regulation requires that the auditor forms an opinion as to whether the summary financial report is consistent with the reporting documents (defined by section 357(2) of the CO as the annual financial statements for the year, directors' report for the year and the auditor's report) from which it is derived and whether it complies with the requirements of Part 2 (i.e. sections 3 to 6) of the Companies (Summary Financial Reports) Regulation.

Consistency with the Annual Financial Statements, Directors' Report and Auditor's Report

12. The auditor states whether in his/ her opinion the summary financial report is consistent with the annual financial statements, directors' report and auditor's report. The auditor is not required to form an opinion on whether the summary financial report gives a true and fair view. It is in any event most unlikely that the summary financial report could give a true and fair view in any practical situation, as much of the detailed information from which it has been extracted is not presented. Members and other users do not, therefore, have the same expectations of the summary financial report as they do of the annual financial statements.

13. Matters which may give rise to an inconsistency include:

    (a) information which has been inaccurately extracted from the annual financial statements, directors' report and auditor's report; and

    (b) information which, in the auditor's opinion, has been summarised in a manner which is not consistent with the annual financial statements, directors' report and auditor's report.

Compliance with Part 2 of the Companies (Summary Financial Reports) Regulation

14. In order to give the opinion required by section 4(5) of the Companies (Summary Financial Reports) Regulation (paragraph 11 above), the auditor gives consideration to the specific and detailed requirements of Part 2 of the Companies (Summary Financial Reports) Regulation. The auditor includes within the scope of his/ her examination all matters required to be included in the summary financial report by Part 2 of the Companies (Summary Financial Reports) Regulation.

15. Under section 4(1) of the Companies (Summary Financial Reports) Regulation, the summary financial report must contain a statement from the auditor as to whether the auditor's report for that financial year is qualified or otherwise modified (including situations set out in sections 4(2) – (4) of the Companies (Summary Financial Reports) Regulation), or includes a reference to any matter to which the auditor drew attention by way of emphasis without qualifying the report; and if the auditor's report is qualified or otherwise modified, set out in the summary financial report the full auditor's report and any further material necessary for the understanding of the qualification or other modification. Therefore, where such a qualification or other modification includes a reference to a note to the annual financial statements but does not reproduce the relevant information contained in that note, that information is also reproduced in the summary financial report to accompany the auditor's report on the annual financial statements.

16. An inconsistency between the summary financial report and the annual financial statements, directors' report and auditor's report also means that the summary financial report is not properly derived from them and does not comply with the Companies (Summary Financial Reports) Regulation, it therefore leads to a qualification of the auditor's report on the summary financial report on the grounds of non-compliance with the requirements of Part 2 of the Companies (Summary Financial Reports) Regulation as well as on the grounds of the inconsistency.

Appendix 3

Extracts of the Relevant Sections of the Companies Ordinance and the Companies (Summary Financial Reports) Regulation on the Form and Contents of Summary Financial Report

Companies Ordinance -

439. Directors may prepare financial report in summary form

(1) The directors of a company may prepare for a financial year a financial report, in summary form, derived from the reporting documents for the financial year, a copy of which is required to be sent to every member of the company under section 430.

(2) A financial report prepared under subsection (1)—

(a) must contain the information prescribed by the Regulation; and

(b) must comply with other requirements prescribed by the Regulation.

(3) If subsection (2) is contravened—

(a) a director who failed to take all reasonable steps to secure compliance with that subsection commits an offence and is liable to a fine of $300,000; and

(b) a director who wilfully failed to take all reasonable steps to secure compliance with that subsection commits an offence and is liable to a fine of $300,000 and to imprisonment for 12 months.

(4) If a person is charged with an offence under subsection (3)(a), it is a defence to establish that the person had reasonable grounds to believe, and did believe, that a competent and reliable person—

(a) was charged with the duty of ensuring that subsection (2) was complied with; and

(b) was in a position to discharge that duty.

440. Summary financial report to be approved and signed

(1) A summary financial report—

(a) must be approved by the directors; and

(b) must be signed on the directors' behalf by a director.

(2) Every copy of a summary financial report sent to a member under this Division or otherwise circulated, published or issued by the company must state the name of the director who signed the report on the directors' behalf.

(3) If, as respect any summary financial report a copy of which is circulated, published or issued by the company, subsection (1) is contravened, the company, and every responsible person of the company, commit an offence, and each is liable to a fine at level 4.

(4) If subsection (2) is contravened, the company, and every responsible person of the company, commit an offence, and each is liable to a fine at level 4.

441. Company may send copy of summary financial report to member

(1) If a company is required to send a copy of the reporting documents for a financial year to a member under section 430, the company may send a copy of the summary financial report for the financial year (if any) to the member instead.

(2) If a company sends a copy of the summary financial report for a financial year to a member under subsection (1), the copy must be sent during the period within which a copy of the reporting documents for the financial year would be required to be sent to the member by the company under section 430.

Companies (Summary Financial Reports) Regulation

Part 2 Summary Financial Report

3. **Form and contents of summary financial report: general**

(1) A summary financial report for a financial year of a company must contain the information derived from the reporting documents for the financial year of the company.

(2) A summary financial report for a financial year of a company must contain the information and particulars set out in subsection (3).

(3) The information and particulars referred to in subsection (2) are—

(a) all the information and particulars included in the following statements of the company relating to the financial year—

(i) statement of financial position; and

(ii) statement of comprehensive income;

(b) if the company is a holding company, all the information and particulars included in the following statements of the company relating to the financial year—

(i) consolidated statement of financial position; and

(ii) consolidated statement of comprehensive income;

(c) if the company's reporting documents for the financial year include a separate income statement in addition to the company's statement of comprehensive income, all the information and particulars included in the income statement;

(d) if the company is a holding company and its reporting documents for the financial year include a separate consolidated income statement in addition to the company's consolidated statement of comprehensive income, all the information and particulars included in the consolidated income statement; and

(e) all the information and particulars—

(i) included in the directors' report of the company for the financial year as required under—

(A) sections 388 and 390 of the Ordinance; and

(B) the Companies (Directors' Report) Regulation; and

(ii) contained in the notes to the financial statements for the financial year as prescribed by the Disclosure Regulation.

4. **Form and contents of summary financial report: auditor's report and opinion**

(1) A summary financial report for a financial year of a company must—

(a) contain a statement from the company's auditor as to whether the auditor's report for that financial year is qualified or otherwise modified, or includes a reference to any matter to which the auditor drew attention by way of emphasis without qualifying the report; and

(b) if the auditor's report is qualified or otherwise modified, set out the full auditor's report and any further material necessary for the understanding of the qualification or other modification.

(2) If the auditor's report of a company contains a statement that, in the auditor's opinion, the financial statements for a financial year of the company have not been properly prepared in compliance with the Ordinance, and in particular—

(a) a true and fair view of the financial position and financial performance of the company has not been given; or

(b) for a company that is required to prepare annual consolidated financial statements, a true and fair view of the financial position and financial performance of the company, and all the subsidiary undertakings, as a whole has not been given,

a summary financial report for that financial year must contain that statement.

(3) If the auditor's report of a company contains a statement that, in the auditor's opinion, the information in a director's report for a financial year is not consistent with the financial statements for the financial year, a summary financial report for that financial year must contain that statement.

(4) If the auditor's report for a financial year of a company contains—

(a) a statement that, in the auditor's opinion—

(i) adequate accounting records have not been kept by the company; or

(ii) the company's financial statements are not in agreement with its accounting records in any material respect;

(b) a statement that the auditor has failed to obtain all the information or explanations that, to the best of the auditor's knowledge and belief, are necessary and material for the purpose of the audit; and

(c) a statement giving the particulars that are required to be, but have not been, contained in the financial statements, as required by section 407(4) of the Ordinance,

a summary financial report for that financial year must contain those statements.

(5) A summary financial report of a company must contain an opinion from the company's auditor as to whether—

(a) the report is consistent with the reporting documents from which the report is derived; and

(b) the report complies with the requirements of this Part.

5. **Form and contents of summary financial report: other matters**

(1) - (2) (Repealed L.N. 48 of 2013)

(3) If a company is not required to prepare annual consolidated financial statements, a summary financial report of the company must contain, in a prominent position (but not necessarily on the front cover) of the report, a statement to the effect that—

(a) the report only gives a summary of the information and particulars contained in the reporting documents of the company from which the report is derived; and

(b) a member of the company may obtain from the company free of charge a copy of the reporting documents if a request is made on or before the specified date.

(4) If a company is required to prepare annual consolidated financial statements, a summary financial report of the company must contain, in a prominent position (but not necessarily on the front cover) of the report, a statement to the effect that—

(a) the report only gives a summary of the information and particulars contained in the reporting documents of the company, and its subsidiary undertakings, from which the report is derived; and

(b) a member of the company may obtain from the company free of charge a copy of the reporting documents if a request is made on or before the specified date.

(5) A summary financial report for a financial year of a company must contain, in a prominent position (but not necessarily on the front cover) of the report, a statement about how a member of the company may obtain from the company free of charge a copy of the reporting documents from which the report is derived.

(6) This section does not prohibit a company from including in its summary financial report for a financial year any other information or particulars which

(a) the company considers appropriate; and

(b) is not inconsistent with the reporting documents of the company for the financial year from which the report is derived.

(7) In this section—

specified date (指明日期)—

(a) if a company is required to hold an annual general meeting in accordance with section 610 of the Ordinance in respect of a financial year, means the day immediately before the expiry of a period of 6 months after the date of the annual general meeting on which a copy of the reporting documents is to be laid;

(b) if a copy of the reporting documents is laid at a general meeting subsequent to an annual general meeting, means the day immediately before the expiry of a period of 6 months after the date of the subsequent meeting; or

(c) if, by virtue of section 612(2) of the Ordinance, a company is not required to hold an annual general meeting in accordance with section 610 of the Ordinance in respect of a financial year, means the day immediately before the expiry of a period of 6 months after the date on which a copy of the reporting documents for the financial year is sent under section 430(3) of the Ordinance.

6. Other requirements in relation to form of summary financial report

Subject to this Regulation, a company may specify any other requirements in relation to the form of its summary financial report that the company considers appropriate.