

MEMBERS' HANDBOOK

Update No. 69

(Issued September 2009)

This Update contains the third part of the Hong Kong Clarified Pronouncements on Auditing.

BACKGROUND ABOUT HONG KONG CLARIFIED PRONOUNCEMENTS ON AUDITING:

Hong Kong Clarified Pronouncements on Auditing are issued in response to the International Auditing and Assurance Standards Board's (IAASB) Clarity Project to improve understandability of the auditing standards. The full set of clarified standards includes 39 documents as follows:

- a new Hong Kong Standard on Auditing (HKSA) on communicating deficiencies in internal control;
- 35 clarified HKSAs;
- a clarified Hong Kong Standard on Quality Control;
- a revised Glossary of Terms; and
- a revised Preface to the Hong Kong Standards on Quality Control, Auditing, Review, Other Assurance and Related Services.

Unless otherwise specified, the clarified pronouncements are effective for audits of financial statements for periods beginning on or after 15 December 2009.

The first two parts covering 27 documents were issued in June and July 2009 respectively. Part 3 covers 8 documents as set out below.

The Institute's Alert 4 which sets out further details on the IAASB Clarity Project can be accessed at: http://www.hkicpa.org.hk/professionaltechnical/financialauditing/pdf_file/2009/FRAA_04.pdf

Document Reference and Title	Instructions	Explanations
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1 Glossary of Terms Relating to Hong Kong Standards on Quality Control, Auditing, Review, Other Assurance and Related Services (Clarified)	Insert these pages after Preface to Hong Kong Standards on Quality Control, Auditing, Review, Other Assurance and Related Services (Revised).	See above

2	HKSA 510 (Clarified) <u>Initial Audit Engagements—Opening Balances</u>	Insert these pages after HKSA 501 (Clarified).	- ditto -
3	HKSA 600 (Clarified) <u>Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)</u>	Insert these pages after HKSA 580 (Clarified).	- ditto -
4	HKSA 700 (Clarified) <u>Forming an Opinion and Reporting on Financial Statements</u>	Insert these pages after HKSA 620 (Clarified).	- ditto -
5	HKSA 705 (Clarified) <u>Modifications to the Opinion in the Independent Auditor’s Report</u>	Insert these pages after HKSA 700 (Clarified).	- ditto -
6	HKSA 706 (Clarified) <u>Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report</u>	Insert these pages after HKSA 705 (Clarified).	- ditto -
7	HKSA 710 (Clarified) <u>Comparative Information—Corresponding Figures and Comparative Financial Statements</u>	Insert these pages after HKSA 706 (Clarified).	- ditto -
8	HKSA 720 (Clarified) <u>The Auditor’s Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements</u>	Insert these pages after HKSA 710 (Clarified).	- ditto -



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Glossary of Terms Relating to Hong Kong Standards on Quality Control, Auditing, Review, Other Assurance and Related Services



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GLOSSARY OF TERMS RELATING TO HONG KONG STANDARDS ON QUALITY CONTROL, AUDITING, REVIEW, OTHER ASSURANCE AND RELATED SERVICES ¹

(September 2009)

Access controls - Procedures designed to restrict access to on-line terminal devices, programs and data. Access controls consist of “user authentication” and “user authorization.” “User authentication” typically attempts to identify a user through unique logon identifications, passwords, access cards or biometric data. “User authorization” consists of access rules to determine the computer resources each user may access. Specifically, such procedures are designed to prevent or detect:

- (a) Unauthorized access to on-line terminal devices, programs and data;
- (b) Entry of unauthorized transactions;
- (c) Unauthorized changes to data files;
- (d) The use of computer programs by unauthorized personnel; and
- (e) The use of computer programs that have not been authorized.

**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 HKSA 540 ² addresses only accounting estimates involving measurement at fair value, the term “fair value accounting estimates” is used.

**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 formal journal entries; and records such as work sheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures.

Agreed-upon procedures engagement - An engagement in which an auditor is engaged to carry out those procedures of an audit nature to which the auditor and the entity and any appropriate third parties have agreed and to report on factual findings. The recipients of the report form their own conclusions from the report by the auditor. The report is restricted to those parties that have agreed to the procedures to be performed since others, unaware of the reasons for the procedures may misinterpret the results.

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

* Denotes a term defined in the HKSAs.

† Denotes a term defined in HKSQC 1.

¹ In the case of public sector engagements, the terms in this glossary should be read as referring to their public sector equivalents.

Where accounting terms have not been defined in the pronouncements of the Hong Kong Institute of Certified Public Accountants, reference should be made to the Glossary of Terms published by the Hong Kong Institute of Certified Public Accountants.

² HKSA 540, “Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures.”

Annual report - A document issued by an entity, ordinarily on an annual basis, which includes its financial statements together with the auditor's report thereon.

**Anomaly* - A misstatement or deviation that is demonstrably not representative of misstatements or deviations in a population.

**Applicable financial reporting framework* - The financial reporting framework adopted by management and, where appropriate, those charged with governance in the preparation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation.

The term "fair presentation framework" is used to refer to a financial reporting framework that requires compliance with the requirements of the framework and:

- (a) 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
- (b) 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 (a) or (b) above.

Application controls in information technology - Manual or automated procedures that typically operate at a business process level. Application controls can be preventative or detective in nature and are designed to ensure the integrity of the accounting records. Accordingly, application controls relate to procedures used to initiate, record, process and report transactions or other financial data.

**Applied criteria (in the context of HKSA 810³)* - The criteria applied by management in the preparation of the summary financial statements.

**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.

**Arm's length transaction* - A transaction conducted on such terms and conditions as between a willing buyer and a willing seller who are unrelated and are acting independently of each other and pursuing their own best interests.

**Assertions* - Representations by management, explicit or otherwise, that are embodied in the financial statements, as used by the auditor to consider the different types of potential misstatements that may occur.

Assess - Analyze identified risks of to conclude on their significance. "Assess," by convention, is used only in relation to risk. (also see *Evaluate*)

Association - (see *Auditor association with financial information*)

*[†]*Assurance* - (see *Reasonable assurance*)

³ HKSA 810, "Engagements to Report on Summary Financial Statements."

Assurance engagement - An engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria. The outcome of the evaluation or measurement of a subject matter is the information that results from applying the criteria (also see *Subject matter information*). Under the “Hong Kong Framework for Assurance Engagements” there are two types of assurance engagement a practitioner is permitted to perform: a reasonable assurance engagement and a limited assurance engagement.

Reasonable assurance engagement - The objective of a reasonable assurance engagement is a reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement ⁴ as the basis for a positive form of expression of the practitioner’s conclusion.

Limited assurance engagement - The objective of a limited assurance engagement is a reduction in assurance engagement risk to a level that is acceptable in the circumstances of the engagement, but where that risk is greater than for a reasonable assurance engagement, as the basis for a negative form of expression of the practitioner’s conclusion.

Assurance engagement risk - The risk that the practitioner expresses an inappropriate conclusion when the subject matter information is materially misstated.

**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).

**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. (See *Sufficiency of audit evidence* and *Appropriateness of audit evidence*.)

**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.

*[†]*Audit firm* - (see *Firm*)

**Audit opinion* - (see *Modified opinion* and *Unmodified opinion*)

**Audit risk* - The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk.

**Audit sampling (sampling)* - The application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.

**Audited financial statements (in the context of HKSA 810)* - Financial statements ⁵ audited by the auditor in accordance with HKSAs, and from which the summary financial statements are derived.

⁴ Engagement circumstances include the terms of the engagement, including whether it is a reasonable assurance engagement or a limited assurance engagement, the characteristics of the subject matter, the criteria to be used, the needs of the intended users, relevant characteristics of the responsible party and its environment, and other matters, for example events, transactions, conditions and practices, that may have a significant effect on the engagement.

⁵ 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.”

**Auditor* - “Auditor” is used to refer to the person or persons conducting the audit, usually the engagement partner or other members of the engagement team, or, as applicable, the firm. Where an HKSA expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the term “engagement partner” rather than “auditor” is used. “Engagement partner” and “firm” are to be read as referring to their public sector equivalents where relevant.

Auditor association with financial information - An auditor is associated with financial information when the auditor attaches a report to that information or consents to the use of the auditor’s name in a professional connection.

**Auditor’s expert* - An individual or organization possessing expertise in a field other than accounting or auditing, whose work in that field is used by the auditor to assist the auditor in obtaining sufficient appropriate audit evidence. An auditor’s expert may be either an auditor’s internal expert (who is a partner⁶ or staff, including temporary staff, of the auditor’s firm or a network firm), or an auditor’s external expert.

**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.

**Auditor’s range* - (see *Auditor’s point estimate*)

**Business risk* - A risk resulting from significant conditions, events, circumstances, actions or inactions that could adversely affect an entity’s ability to achieve its objectives and execute its strategies, or from the setting of inappropriate objectives and strategies.

**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.

**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.

Compilation engagement - An engagement in which accounting expertise, as opposed to auditing expertise, is used to collect, classify and summarize financial information.

**Complementary user entity controls* - Controls that the service organization assumes, in the design of its service, will be implemented by user entities, and which, if necessary to achieve control objectives, are identified in the description of its system.

**Compliance framework* - (see *Applicable financial reporting framework* and *General purpose framework*)

**Component* - An entity or business activity for which group or component management prepares financial information that should be included in the group financial statements.

**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.

**Component management* - Management responsible for the preparation of the financial information of a component.

**Component materiality* - The materiality for a component determined by the group engagement team.

⁶ “Partner” and “firm” should be read as referring to their public sector equivalents where relevant.

Computer-assisted audit techniques - Applications of auditing procedures using the computer as an audit tool (also known as CAATs).

Control activities - Those policies and procedures that help ensure that management directives are carried out. Control activities are a component of internal control.

Control environment - Includes the governance and management functions and the attitudes, awareness and actions of those charged with governance and management concerning the entity's internal control and its importance in the entity. The control environment is a component of internal control.

**Control risk* - (see *Risk of material misstatement*)

Corporate governance - (see *Governance*)

**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.

Criteria - The benchmarks used to evaluate or measure the subject matter including, where relevant, benchmarks for presentation and disclosure. Criteria can be formal or less formal. There can be different criteria for the same subject matter. Suitable criteria are required for reasonably consistent evaluation or measurement of a subject matter within the context of professional judgment.

Suitable criteria - Exhibit the following characteristics:

- (a) **Relevance:** relevant criteria contribute to conclusions that assist decision making by the intended users.
- (b) **Completeness:** criteria are sufficiently complete when relevant factors that could affect the conclusions in the context of the engagement circumstances are not omitted. Complete criteria include, where relevant, benchmarks for presentation and disclosure.
- (c) **Reliability:** reliable criteria allow reasonably consistent evaluation or measurement of the subject matter including, where relevant, presentation and disclosure, when used in similar circumstances by similarly qualified practitioners.
- (d) **Neutrality:** neutral criteria contribute to conclusions that are free from bias.
- (e) **Understandability:** understandable criteria contribute to conclusions that are clear, comprehensive, and not subject to significantly different interpretations.

**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.

†*Date of report (in relation to quality control)* - The date selected by the practitioner to date the report.

**Date of the auditor's report* - The date the auditor dates the report on the financial statements in accordance with HKSA 700.⁷

⁷ HKSA 700, "Forming an Opinion and Reporting on Financial Statements."

**Date of the financial statements* - The date of the end of the latest period covered by the financial statements.

**Date the financial statements are issued* - The date that the auditor's report and audited financial statements are made available to third parties.

**Deficiency in internal control* - This exists when:

- (a) A control is designed, implemented or operated in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements on a timely basis; or
- (b) A control necessary to prevent, or detect and correct, misstatements in the financial statements on a timely basis is missing.

**Detection risk* - The risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.

**Element* - (see *Element of a financial statement*)

**Element of a financial statement (in the context of HKSA 805⁸)* - An element, account or item of a financial statement.

**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.

†*Engagement documentation* - The record of work performed, results obtained, and conclusions the practitioner reached (terms such as "working papers" or "workpapers" are sometimes used).

Engagement letter - Written terms of an engagement in the form of a letter.

*†*Engagement partner*⁹ - The partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.

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

*†*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 report.

*†*Engagement team* - All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform procedures on the engagement. This excludes external experts engaged by the firm or a network firm.¹⁰

⁸ HKSA 805, "Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement."

⁹ "Engagement partner," "partner," and "firm" should be read as referring to their public sector equivalents where relevant.

¹⁰ HKSA 620, "Using the Work of an Auditor's Expert," paragraph 6(a), defines the term "auditor's expert."

Entity's risk assessment process - A component of internal control that is the entity's process for identifying business risks relevant to financial reporting objectives and deciding about actions to address those risks, and the results thereof.

Environmental matters -

- (a) Initiatives to prevent, abate, or remedy damage to the environment, or to deal with conservation of renewable and non-renewable resources (such initiatives may be required by environmental laws and regulations or by contract, or they may be undertaken voluntarily);
- (b) Consequences of violating environmental laws and regulations;
- (c) Consequences of environmental damage done to others or to natural resources; and
- (d) Consequences of vicarious liability imposed by law (for example, liability for damages caused by previous owners).

Environmental performance report - A report, separate from the financial statements, in which an entity provides third parties with qualitative information on the entity's commitments towards the environmental aspects of the business, its policies and targets in that field, its achievement in managing the relationship between its business processes and environmental risk, and quantitative information on its environmental performance.

Environmental risk - In certain circumstances, factors relevant to the assessment of inherent risk for the development of the overall audit plan may include the risk of material misstatement of the financial statements due to environmental matters.

Error - An unintentional misstatement in financial statements, including the omission of an amount or a disclosure.

**Estimation uncertainty* - The susceptibility of an accounting estimate and related disclosures to an inherent lack of precision in its measurement.

Evaluate - Identify and analyze the relevant issues, including performing further procedures as necessary, to come to a specific conclusion on a matter. "Evaluation," by convention, is used only in relation to a range of matters, including evidence, the results of procedures and the effectiveness of management's response to a risk. (also see *Assess*)

**Exception* - A response that indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party.

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

- (a) Audit processes;
- (b) HKSAs and applicable legal and regulatory requirements;
- (c) The business environment in which the entity operates; and
- (d) Auditing and financial reporting issues relevant to the entity's industry.

**Expert* - (see *Auditor's expert* and *Management's expert*)

**Expertise* - Skills, knowledge and experience in a particular field.

**External confirmation* - Audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium.

**Fair presentation framework* - (see *Applicable financial reporting framework* and *General purpose framework*)

**Financial statements* - A structured representation of historical financial information, including related notes, intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information. The term "financial statements" ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework, but it can also refer to a single financial statement.

*[†]*Firm* - A sole practitioner, partnership or corporation or other entity of professional accountants.

Forecast - Prospective financial information prepared on the basis of assumptions as to future events which management expects to take place and the actions management expects to take as of the date the information is prepared (best-estimate assumptions).

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

**Fraud risk factors* - Events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud.

Fraudulent financial reporting - Involves intentional misstatements, including omissions of amounts or disclosures in financial statements, to deceive financial statement users.

General IT-controls - Policies and procedures that relate to many applications and support the effective functioning of application controls by helping to ensure the continued proper operation of information systems. General IT-controls commonly include controls over data center and network operations; system software acquisition, change and maintenance; access security; and application system acquisition, development, and maintenance.

**General purpose financial statements* - Financial statements prepared in accordance with a general purpose framework.

**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:

- (a) 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
- (b) 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 (a) or (b) above.¹¹

**Governance* - Describes the role of person(s) or organization(s) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity.

**Group* - All the components whose financial information is included in the group financial statements. A group always has more than one component.

**Group audit* - The audit of group financial statements.

**Group audit opinion* - The audit opinion on the group financial statements.

**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.

**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.

**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.

**Group management* - Management responsible for the preparation of the group financial statements.

**Group-wide controls* - Controls designed, implemented and maintained by group management over group financial reporting.

**Historical financial information* - Information expressed in financial terms in relation to a particular entity, derived primarily from that entity’s accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.

**Hong Kong Financial Reporting Standards* - The Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants.

**Inconsistency* - Other information that contradicts information contained in the audited financial statements. A material inconsistency may raise doubt about the audit conclusions drawn from audit evidence previously obtained and, possibly, about the basis for the auditor’s opinion on the financial statements.

*Independence*¹² - Comprises:

- (a) Independence of mind - the state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional skepticism.

¹¹ HKSA 200, paragraph 13(a).

¹² As defined in the *Code of Ethics for Professional Accountants*.

- (b) Independence in appearance - the avoidance of facts and circumstances that are so significant a reasonable and informed third party, having knowledge of all relevant information, including any safeguards applied, would reasonably conclude a firm's, or a member of the assurance team's, integrity, objectivity or professional skepticism had been compromised.

Information system relevant to financial reporting - A component of internal control that includes the financial reporting system, and consists of the procedures and records established to initiate, record, process and report entity transactions (as well as events and conditions) and to maintain accountability for the related assets, liabilities and equity.

**Inherent risk* - (see *Risk of material misstatement*)

**Initial audit engagement* - An engagement in which either:

- (a) The financial statements for the prior period were not audited; or
 (b) The financial statements for the prior period were audited by a predecessor auditor.

Inquiry - Inquiry consists of seeking information of knowledgeable persons, both financial and non-financial, within the entity or outside the entity.

Inspection (as an audit procedure) - Examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset.

*[†]*Inspection (in relation to quality control)* - In relation to completed engagements, procedures designed to provide evidence of compliance by engagement teams with the firm's quality control policies and procedures.

Intended users - The person, persons or class of persons for whom the practitioner prepares the assurance report. The responsible party can be one of the intended users, but not the only one.

Interim financial information or statements - Financial information (which may be less than a complete set of financial statements as defined above) issued at interim dates (usually half-yearly or quarterly) in respect of a financial period.

**Internal audit function* - An appraisal activity established or provided as a service to the entity. Its functions include, amongst other things, examining, evaluating and monitoring the adequacy and effectiveness of internal control.

**Internal auditors* - Those individuals who perform the activities of the internal audit function. Internal auditors may belong to an internal audit department or equivalent function.

**Internal control* - The process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. The term "controls" refers to any aspects of one or more of the components of internal control.

Investigate - Inquire into matters arising from other procedures to resolve them.

IT environment - The policies and procedures that the entity implements and the IT infrastructure (hardware, operating systems, etc.) and application software that it uses to support business operations and achieve business strategies.

Limited assurance engagement - (see *Assurance engagement*)

*[†]*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.

**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.

**Management bias* - A lack of neutrality by management in the preparation of information.

**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.

**Management's point estimate* - The amount selected by management for recognition or disclosure in the financial statements as an accounting estimate.

Misappropriation of assets - Involves the theft of an entity's assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it can also involve management who are usually more capable of disguising or concealing misappropriations in ways that are difficult to detect.

**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.

Where 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.

**Misstatement of fact* - Other information that is unrelated to matters appearing in the audited financial statements that is incorrectly stated or presented. A material misstatement of fact may undermine the credibility of the document containing audited financial statements.

**Modified opinion* - A qualified opinion, an adverse opinion or a disclaimer of opinion.

*[†]*Monitoring (in relation to quality control)* - 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.

Monitoring of controls - A process to assess the effectiveness of internal control performance over time. It includes assessing the design and operation of controls on a timely basis and taking necessary corrective actions modified for changes in conditions. Monitoring of controls is a component of internal control.

**Negative confirmation request* - A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.

*[†]*Network* - A larger structure:

- (a) That is aimed at cooperation, and
- (b) 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.

*[†]*Network firm* - A firm or entity that belongs to a network.

**Non-compliance (in the context of HKSA 250¹³)* - Acts of omission or commission by the entity, either intentional or unintentional, which are contrary to the prevailing laws or regulations. Such acts include transactions entered into by, or in the name of, the entity, or on its behalf, by those charged with governance, management or employees. Noncompliance does not include personal misconduct (unrelated to the business activities of the entity) by those charged with governance, management or employees of the entity.

**Non-response* - A failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered.

**Non-sampling risk* - The risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk.

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.

**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.

**Other information* - Financial and non-financial information (other than the financial statements and the auditor's report thereon) which is included, either by law, regulation, or custom, in a document containing audited financial statements and the auditor's report thereon.

**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.

**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.

Overall audit strategy - Sets the scope, timing and direction of the audit, and guides the development of the more detailed audit plan.

*[†]*Partner* - Any individual with authority to bind the firm with respect to the performance of a professional services engagement.

¹³ HKSA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements."

**Performance materiality* - The amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. If applicable, performance materiality also refers to the amount or amounts set by the auditor at less than the materiality level or levels for particular classes of transactions, account balances or disclosures.

**[†]Personnel* - Partners and staff.

**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:

- (a) Are not confined to specific elements, accounts or items of the financial statements;
- (b) If so confined, represent or could represent a substantial proportion of the financial statements; or
- (c) In relation to disclosures, are fundamental to users' understanding of the financial statements.

**Population* - The entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions.

**Positive confirmation request* - A request that the confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request, or providing the requested information.

Practitioner - A professional accountant in public practice.

**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 premise¹⁴ on which an audit is conducted.

**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.

**Premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit is conducted* - That management and, where appropriate, those charged with governance have acknowledged and understand that they have the following responsibilities that are fundamental to the conduct of an audit in accordance with HKSA. That is, responsibility:

- (a) For the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation;
- (b) For such internal control as management and, where appropriate, those charged with governance determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
- (c) To provide the auditor with:

¹⁴ HKSA 200, paragraph 13.

- (i) Access to all information of which management and, where appropriate, those charged with governance are aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
- (ii) Additional information that the auditor may request from management and, where appropriate, those charged with governance for the purpose of the audit; and
- (iii) Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

In the case of a fair presentation framework, (a) above may be restated as “for the preparation and *fair* presentation of the financial statements in accordance with the financial reporting framework,” or “for the preparation of financial statements *that give a true and fair view* in accordance with the financial reporting framework.”

The “premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit is conducted” may also be referred to as the “premise.”

*Professional accountant*¹⁵ - An individual who is a member of the Hong Kong Institute of Certified Public Accountants.

*Professional accountant in public practice*¹⁶ - A professional accountant, irrespective of functional classification (for example, audit, tax or consulting) in a firm that provides professional services. This term is also used to refer to a firm of professional accountants in public practice.

**Professional judgment* - The application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement.

**Professional skepticism* - An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of evidence.

**Professional standards* - Hong Kong Standards on Auditing (HKSA) and relevant ethical requirements

†*Professional standards (in the context of HKSQC 1*¹⁷*)* - Hong Kong Engagement Standards, as defined in the *Preface to Hong Kong Standards on Quality Control, Auditing, Review, Other Assurance and Related Services*, and relevant ethical requirements.

Projection - Prospective financial information prepared on the basis of:

- (a) Hypothetical assumptions about future events and management actions which are not necessarily expected to take place, such as when some entities are in a startup phase or are considering a major change in the nature of operations; or
- (b) A mixture of best-estimate and hypothetical assumptions.

Prospective financial information - Financial information based on assumptions about events that may occur in the future and possible actions by an entity. Prospective financial information can be in the form of a forecast, a projection or a combination of both. (see *Forecast* and *Projection*)

¹⁵ As defined in the *Code of Ethics for Professional Accountants*.

¹⁶ As defined in the *Code of Ethics for Professional Accountants*.

¹⁷ HKSQC 1, “Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements.”

Public sector - National governments, regional (for example, state, provincial, territorial) governments, local (for example, city, town) governments and related governmental entities (for example, agencies, boards, commissions and enterprises).

*[†]*Reasonable assurance (in the context of assurance engagements, including audit engagements, and quality control)* - A high, but not absolute, level of assurance.

Reasonable assurance engagement - (see *Assurance engagement*)

Recalculation - Consists of checking the mathematical accuracy of documents or records.

**Related party* - A party that is either:

- (a) A related party as defined in the applicable financial reporting framework; or
- (b) Where the applicable financial reporting framework establishes minimal or no related party requirements:
 - (i) A person or other entity that has control or significant influence, directly or indirectly through one or more intermediaries, over the reporting entity;
 - (ii) Another entity over which the reporting entity has control or significant influence, directly or indirectly through one or more intermediaries; or
 - (iii) Another entity that is under common control with the reporting entity through having:
 - a. Common controlling ownership;
 - b. Owners who are close family members; or
 - c. Common key management.

However, entities that are under common control by a state (that is, a national, regional or local government) are not considered related unless they engage in significant transactions or share resources to a significant extent with one another.

Related services - Comprise agreed-upon procedures and compilations.

*[†]*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) together with national requirements that are more restrictive.

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

**Report on the description and design of controls at a service organization (referred to in HKSA 402¹⁸ as a type 1 report)* - A report that comprises:

- (a) A description, prepared by management of the service organization, of the service organization's system, control objectives and related controls that have been designed and implemented as at a specified date; and

¹⁸ HKSA 402, "Audit Considerations Relating to an Entity Using a Service Organization."

- (b) A report by the service auditor with the objective of conveying reasonable assurance that includes the service auditor's opinion on the description of the service organization's system, control objectives and related controls and the suitability of the design of the controls to achieve the specified control objectives.

**Report on the description, design, and operating effectiveness of controls at a service organization (referred to in HKSA 402 as a type 2 report) - A report that comprises:*

- (a) A description, prepared by management of the service organization, of the service organization's system, control objectives and related controls, their design and implementation as at a specified date or throughout a specified period and, in some cases, their operating effectiveness throughout a specified period; and
- (b) A report by the service auditor with the objective of conveying reasonable assurance that includes:
 - (i) The service auditor's opinion on the description of the service organization's system, control objectives and related controls, the suitability of the design of the controls to achieve the specified control objectives, and the operating effectiveness of the controls; and
 - (ii) A description of the service auditor's tests of the controls and the results thereof.

Responsible party - The person (or persons) who:

- (a) In a direct reporting engagement, is responsible for the subject matter; or
- (b) In an assertion-based engagement, is responsible for the subject matter information (the assertion), and may be responsible for the subject matter.

The responsible party may or may not be the party who engages the practitioner (the engaging party).

Review (in relation to quality control) - Appraising the quality of the work performed and conclusions reached by others.

Review engagement - The objective of a review engagement is to enable an auditor to state whether, on the basis of procedures which do not provide all the evidence that would be required in an audit, anything has come to the auditor's attention that causes the auditor to believe that the financial statements are not prepared, in all material respects, in accordance with an applicable financial reporting framework.

Review procedures - The procedures deemed necessary to meet the objective of a review engagement, primarily inquiries of entity personnel and analytical procedures applied to financial data.

**Risk assessment procedures* - The audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.

**Risk of material misstatement* - The risk that the financial statements are materially misstated prior to audit. This consists of two components, described as follows at the assertion level:

- (a) *Inherent risk* - The susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls.

- (b) Control risk - The risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.

**Sampling* - (see *Audit sampling*)

**Sampling risk* - The risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk can lead to two types of erroneous conclusions:

- (a) In the case of a test of controls, that controls are more effective than they actually are, or in the case of a test of details, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.
- (b) In the case of a test of controls, that controls are less effective than they actually are, or in the case of a test of details, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

**Sampling unit* - The individual items constituting a population.

Scope of a review - The review procedures deemed necessary in the circumstances to achieve the objective of the review.

**Service auditor* - An auditor who, at the request of the service organization, provides an assurance report on the controls of a service organization.

**Service organization* - A third-party organization (or segment of a third-party organization) that provides services to user entities that are part of those entities' information systems relevant to financial reporting.

**Service organization's system* - The policies and procedures designed, implemented and maintained by the service organization to provide user entities with the services covered by the service auditor's report.

Significance - The relative importance of a matter, taken in context. The significance of a matter is judged by the practitioner in the context in which it is being considered. This might include, for example, the reasonable prospect of its changing or influencing the decisions of intended users of the practitioner's report; or, as another example, where the context is a judgment about whether to report a matter to those charged with governance, whether the matter would be regarded as important by them in relation to their duties. 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.

**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.

**Significant deficiency in internal control* - A deficiency or combination of deficiencies in internal control that, in the auditor's professional judgment, is of sufficient importance to merit the attention of those charged with governance.

**Significant risk* - An identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration.

Smaller entity - An entity which typically possesses qualitative characteristics such as:

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

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

**Special purpose financial statements* - Financial statements prepared in accordance with a special purpose framework.

**Special purpose framework* - A financial reporting framework designed to meet the financial information needs of specific users. The financial reporting framework may be a fair presentation framework or a compliance framework.¹⁹

*[†]*Staff* - Professionals, other than partners, including any experts the firm employs.

**Statistical sampling* - An approach to sampling that has the following characteristics:

- (a) Random selection of the sample items; and
- (b) The use of probability theory to evaluate sample results, including measurement of sampling risk.

A sampling approach that does not have characteristics (a) and (b) is considered nonstatistical sampling.

**Stratification* - The process of dividing a population into sub-populations, each of which is a group of sampling units which have similar characteristics (often monetary value).

Subject matter information - The outcome of the evaluation or measurement of a subject matter. It is the subject matter information about which the practitioner gathers sufficient appropriate evidence to provide a reasonable basis for expressing a conclusion in an assurance report.

**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.

¹⁹ HKSA 200, paragraph 13(a).

**Subservice organization* - A service organization used by another service organization to perform some of the services provided to user entities that are part of those user entities' information systems relevant to financial reporting.

**Substantive procedure* - An audit procedure designed to detect material misstatements at the assertion level. Substantive procedures comprise:

- (a) Tests of details (of classes of transactions, account balances, and disclosures); and
- (b) Substantive analytical procedures.

**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.

Suitable criteria - (see *Criteria*)

*[†]*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 and reviews of historical financial information, or other assurance or related services engagements, or of an organization that provides relevant quality control services.

**Summary financial statements (in the context of HKSA 810)* - 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.²⁰ Different jurisdictions may use different terminology to describe such historical financial information.

Supplementary information - Information that is presented together with the financial statements that is not required by the applicable financial reporting framework used to prepare the financial statements, normally presented in either supplementary schedules or as additional notes.

Test - The application of procedures to some or all items in a population.

**Tests of controls* - An audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.

**Those charged with governance* - The person(s) or organization(s) (for example, 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.²¹

**Tolerable misstatement* - A monetary amount set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is not exceeded by the actual misstatement in the population.

**Total rate of deviation* - A rate of deviation from prescribed internal control procedures set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the rate of deviation set by the auditor is not exceeded by the actual rate of deviation in the population.

²⁰ HKSA 200, paragraph 13(f).

²¹ For discussion of the diversity of governance structures, see paragraphs A1-A8 of HKSA 260, "Communication with Those Charged with Governance."

Uncertainty - A matter whose outcome depends on future actions or events not under the direct control of the entity but that may affect the financial statements.

**Uncorrected misstatements* - Misstatements that the auditor has accumulated during the audit and that have not been corrected.

**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.²²

**User auditor* - An auditor who audits and reports on the financial statements of a user entity.

**User entity* - An entity that uses a service organization and whose financial statements are being audited.

Walk-through test - Involves tracing a few transactions through the financial reporting system.

**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.

²² HKSA 700, paragraphs 35-36, deal with the phrases used to express this opinion in the case of a fair presentation framework and a compliance framework respectively.

HKSA 510
Issued September 2009

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



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

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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)

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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."
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Introduction

Scope of this HKSA

1. This Hong Kong Standard on Auditing (HKSA) deals with the auditor's responsibilities relating to 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 710¹ also apply. HKSA 300² 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.

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

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, 6a, 7a, 9a, 9b, 12a, 13a, 15a 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 their 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.

Illustrations of Auditors' Reports with Modified Opinions

Illustration 1:

Circumstances described in paragraph A8(a) include the following:

- **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.⁶**
- **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.^{5a}**

INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF ABC LIMITED

(incorporated in [country or place] with limited liability)^{6a}

[Report on the Financial Statements]⁷

We have audited the financial statements of ABC Limited ("the Company") set out on pages to, which comprise the [balance sheet][statement of financial position]^{7a} as at 31 December 20X1, and the [income statement][statement of comprehensive income]^{7a}, statement of changes in equity and [cash flow statement][statement of cash flows]^{7a} for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors'⁸ Responsibility for the Financial Statements

The directors are responsible for the preparation of financial statements that give a true and fair view in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants [and the disclosure requirements of the Hong Kong Companies Ordinance^{9a}], and for such internal control as the directors determine is necessary to enable the

⁶ 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.

^{6a} In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

⁷ The sub-title "Report on the Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

^{7a} Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

⁸ Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

⁹ Not used.

^{9a} For a company incorporated overseas and listed in Hong Kong, the disclosure requirements of the Hong Kong Companies Ordinance are applicable.

preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit ^{9b}. 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.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 [profit][loss] and cash flows, we were unable to determine whether adjustments might have been necessary in respect of the [profit][loss] for the year reported in the [income statement][statement of comprehensive income]^{7a} and the net cash flows from operating activities reported in the [cash flow statement][statement of cash flows].^{7a}

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 state of the Company's affairs as at 31 December 20X1, and of its [profit][loss] and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards [and have been properly prepared in accordance with the disclosure requirements of 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.

^{9b} Auditor may consider it appropriate to clarify to whom he/ she is 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".

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."

[Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]]⁷

XYZ & Co.

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

[Auditor's address]

Date of the auditor's report

Illustration 2:

Circumstances described in paragraph A8(b) include the following:

- 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.¹²
- 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.

INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)^{12a}

Report on the Financial Statements

We have audited the financial statements of ABC Limited ("the Company") set out on pages to, which comprise the [balance sheet][statement of financial position]^{13a} as at 31 December 20X1, and the [income statement][statement of comprehensive income]^{13a}, statement of changes in equity and [cash flow statement][statement of cash flows]^{13a} for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors' ¹⁴ Responsibility for the Financial Statements

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

¹² 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.

^{12a} In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

¹³ Not used.

^{13a} Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

¹⁴ Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

¹⁵ Not used.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit ^{15a}. 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.¹⁷ 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 [Profit][Loss] 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 [profit][loss] and cash flows, we were unable to determine whether adjustments might have been necessary in respect of the [profit][loss] for the year reported in the [income statement][statement of comprehensive income]^{13a} and the net cash flows from operating activities reported in the [cash flow statement][statement of cash flows].^{13a}

Qualified Opinion on the [Profit][Loss] and Cash Flows

In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion paragraph, the [income statement][statement of comprehensive income]^{13a} and [cash flow statement][statement of cash flows]^{13a} give a true and fair view of the Company's [profit][loss] and cash flows for the year ended 31 December 20X1 in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

Opinion on the financial position

In our opinion, the [balance sheet][statement of financial position]^{13a} gives a true and fair view of the state of the Company's affairs as at 31 December 20X1 in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

^{15a} Auditor may consider it appropriate to clarify to whom he/ she is 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".

¹⁶ Not used.

¹⁷ 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."

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 matters under sections 141(4) and 141(6) of the Hong Kong Companies Ordinance

In respect alone of the inability to obtain sufficient appropriate audit evidence regarding opening balances of inventory:

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

XYZ & Co.

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

[Auditor's address]

Date of the auditor's report

HKSA 600
Issued September 2009

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)



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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)

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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.”
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Introduction

Scope of this HKSA

1. The Hong Kong Standards on Auditing (HKSA) 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.

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:

- 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
- 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

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, "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.

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)

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- (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

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 260¹² 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 paragraph 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.

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 geographical 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 geographical 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 consideration¹⁴). 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;

¹⁴ HKSA 315, 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.

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 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, paragraphs A17-A41.

- 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, internal audit (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.

¹⁸ HKSA 240, “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements.”

¹⁹ HKSA 240, paragraph 15; HKSA 315, 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.

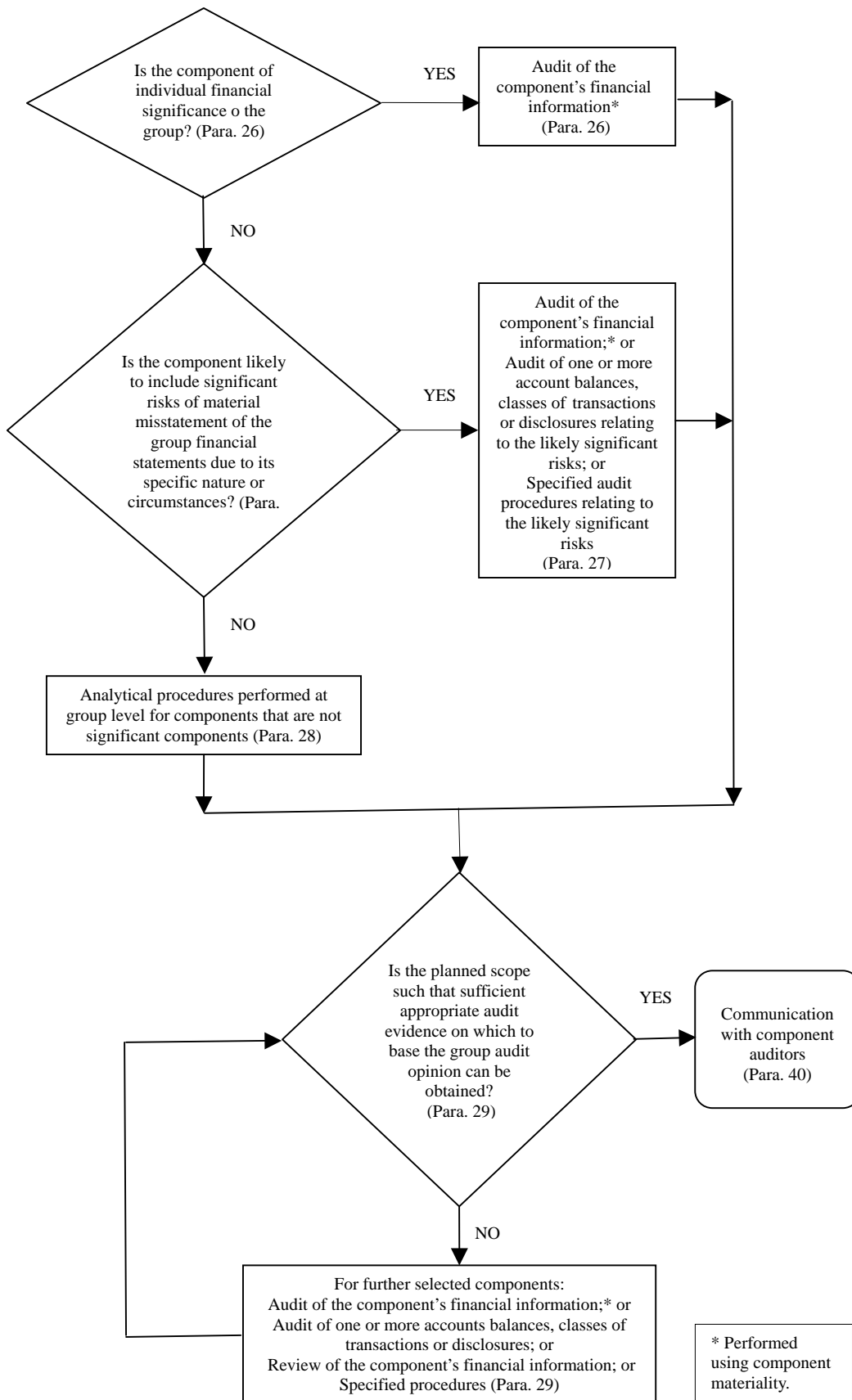
Responding to Assessed Risks

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.

SPECIAL CONSIDERATIONS—AUDITS OF GROUP FINANCIAL STATEMENTS
(Including the Work of Component Auditors)



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 internal audit 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) 2400²² 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 HKSA's 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 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

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 balance sheet, 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^{24a}.

The group engagement team has read the audited financial statements of the component as of December 31, 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 SHAREHOLDERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)^{24b}

Report on the Consolidated Financial Statements

We have audited the consolidated financial statements of ABC Limited (the "Company") and its subsidiaries (together "the Group") set out on pages ... to ..., which comprise the consolidated and company [balance sheets][statements of financial position]^{25a} as at 31 December 20X1, and the consolidated [income statement][statement of comprehensive income]^{25a}, the consolidated statement of changes in equity and the consolidated [cash flow statement][statement of cash flows]^{25a} for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors'²⁶ Responsibility for the Consolidated Financial Statements

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.

^{24a} Additional local guidance is provided in Appendix 6.

^{24b} In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

²⁵ Not used.

^{25a} Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

²⁶ Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

²⁷ Not used.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit ^{27a}. 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 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.²⁹ 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 [balance sheet][statement of financial position]^{25a} as at 31 December 20X1, and ABC Limited's share of XYZ Limited's net income of \$1 million is included in the consolidated [income statement][statement of comprehensive income]^{25a} 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 state of affairs of the Company and of the Group as at 31 December 20X1, and of the Group's [profit][loss] and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

^{27a} Auditor may consider it appropriate to clarify to whom he/ she is 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".

²⁸ Not used.

²⁹ 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 matters under sections 141(4) and 141(6) of the Hong Kong Companies Ordinance

In respect alone of the inability to obtain sufficient appropriate audit evidence regarding an investment in a foreign associate:

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

XYZ & Co.

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

[Auditor's address]

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 internal audit 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. Internal audit may be regarded as part of group-wide controls, for example, when the internal audit function is centralized. HKSA 610³⁰ deals with the group engagement team's evaluation of the competence and objectivity of the internal auditors where it plans to use their work.

³⁰ HKSA 610, "Using the Work of Internal Auditors," paragraph 9.

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.

SPECIAL CONSIDERATIONS—AUDITS OF GROUP FINANCIAL STATEMENTS
(Including the Work of Component Auditors)

- 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 (give a true and fair view of) the financial position of the group as of [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].

SPECIAL CONSIDERATIONS—AUDITS OF GROUP FINANCIAL STATEMENTS
(Including the Work of Component Auditors)

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.*
- *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.

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 internal audit, 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. In Hong Kong where, if a holding company and its subsidiary are incorporated in Hong Kong, section 133(1)(a) of the Companies Ordinance imposes a duty on the subsidiary and its auditors to give to the auditors of the holding company such information and explanation as those auditors may reasonably require for the purposes of their duties as auditors of the holding company.
2. Where a holding company is incorporated in Hong Kong, but its subsidiary is not, section 133(1)(b) of the Companies Ordinance imposes a duty on the holding company, if required by its auditors to do so, to take all such steps as are reasonably open to it to obtain from the subsidiary such information and explanation as the group engagement team may reasonably require for the purpose of their duty as the group engagement team.

HKSA 700
Issued September 2009

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

Hong Kong Standard on Auditing 700

Forming an Opinion and Reporting on Financial Statements



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

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HONG KONG STANDARD ON AUDITING 700**FORMING AN OPINION AND REPORTING ON FINANCIAL STATEMENTS**

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

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Hong Kong Standard on Auditing (HKSA) 700, "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 705 ¹ and HKSA 706 ² 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.
3. This HKSA is written in the context of a complete set of general purpose financial statements. HKSA 800 ³ deals with special considerations when financial statements are prepared in accordance with a special purpose framework. HKSA 805 ⁴ 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.
4. This HKSA promotes consistency in the auditor's report. 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 beginning on or after 15 December 2009.

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
 - (b) To express clearly that opinion through a written report that also describes the basis for that opinion.

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.

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

² HKSA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report."

³ HKSA 800, "Special Considerations—Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks."

⁴ HKSA 805, "Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement."

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.⁵

- (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.⁶
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 Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants (HKICPA).

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.^{7 8}
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;⁹
 - (b) The auditor’s conclusion, in accordance with HKSA 450, whether uncorrected misstatements are material, individually or in aggregate;¹⁰ and
 - (c) The evaluations required by paragraphs 12-15.

⁵ 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).

⁶ Paragraphs 35-36 deal with the phrases used to express this opinion in the case of a fair presentation framework and a compliance framework respectively.

⁷ HKSA 200, paragraph 11.

⁸ Paragraphs 35-36 deal with the phrases used to express this opinion in the case of a fair presentation framework and a compliance framework respectively.

⁹ HKSA 330, “The Auditor’s Responses to Assessed Risks,” paragraph 26.

¹⁰ HKSA 450, “Evaluation of Misstatements Identified during the Audit,” paragraph 11.

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
 - (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.

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. (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 required by the circumstances of the engagement. (Ref: Para. A16)

Introductory Paragraph

23. The introductory paragraph in the auditor's report shall: (Ref: Para. A17-A19)
 - (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 that comprises the financial statements;
 - (d) Refer to the summary of significant accounting policies and other explanatory information; and
 - (e) Specify the date or period covered by each financial statement comprising the financial statements.

Management's Responsibility for the Financial Statements

24. This section of the auditor's report describes the responsibilities of those in the organization that are responsible for the preparation of the financial statements. The auditor's report need not refer specifically to "management," but shall use the term that is appropriate in the context of the legal framework in the particular jurisdiction. In some jurisdictions, the appropriate reference may be to those charged with governance.^{10a}

^{10a} In Hong Kong, under the Hong Kong Companies Ordinance, directors are responsible for the preparation of financial statements that show a true and fair view.

25. The auditor's report shall include a section with the heading "Management's [or other appropriate term] Responsibility for the Financial Statements."
26. The auditor's report shall describe management's responsibility for the preparation of the financial statements. The description shall include an explanation that management is responsible for the preparation of the financial statements in accordance with the applicable financial reporting framework, and 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. (Ref: Para. A20-A23)
27. Where the financial statements are prepared in accordance with a fair presentation framework, the explanation of management's responsibility 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.

Auditor's Responsibility

28. The auditor's report shall include a section with the heading "Auditor's Responsibility."
29. The auditor's report shall state that the responsibility of the auditor is to express an opinion on the financial statements based on the audit. (Ref: Para. A24)
30. The auditor's report shall state that the audit was conducted in accordance with Hong Kong Standards on Auditing. The auditor's report shall also explain that those standards require that the auditor comply with ethical requirements and that the auditor plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. (Ref: Para. A25-A26)
31. The auditor's report shall describe an audit by stating that:
 - (a) An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements;
 - (b) 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 the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. 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 internal control; and
 - (c) An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of accounting estimates made by management, as well as the overall presentation of the financial statements.
32. Where the financial statements are prepared in accordance with a fair presentation framework, the description of the audit in the auditor's report shall refer to "the entity's preparation and fair presentation of the financial statements" or "the entity's preparation of financial statements that give a true and fair view," as appropriate in the circumstances.

33. The auditor's report shall state 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.

Auditor's Opinion

34. The auditor's report shall include a section with the heading "Opinion."
35. 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) The financial statements present fairly, in all material respects, ... in accordance with [the applicable financial reporting framework]; or
 - (b) The financial statements give a true and fair view of ... in accordance with [the applicable financial reporting framework]^{10b}. (Ref: Para. A27-A33)
36. When expressing an unmodified opinion on financial statements prepared in accordance with a compliance framework, the auditor's opinion shall be that the financial statements are prepared, in all material respects, in accordance with [the applicable financial reporting framework]. (Ref: Para. A27, A29-A33)
37. If the reference to the applicable financial reporting framework in the auditor's opinion is not to Hong Kong Financial Reporting Standards issued by the HKICPA, the auditor's opinion shall identify the jurisdiction of origin of the framework.

Other Reporting Responsibilities

38. If the auditor addresses other reporting responsibilities in the auditor's report on the financial statements that are in addition to the auditor's responsibility under HKSA's to report on the financial statements, these other reporting responsibilities shall be addressed in a separate section in the auditor's report that shall be sub-titled "Report on Other Legal and Regulatory Requirements," or otherwise as appropriate to the content of the section.^{10c} (Ref: Para. A34-A35)
39. If the auditor's report contains a separate section on other reporting responsibilities, the headings, statements and explanations referred to in paragraphs 23-37 shall be under the sub-title "Report on the Financial Statements." The "Report on Other Legal and Regulatory Requirements" shall follow the "Report on the Financial Statements." (Ref: Para. A36)

Signature of the Auditor

40. The auditor's report shall be signed. (Ref: Para. A37)

^{10b} In Hong Kong, the Companies Ordinance, the Main Board Listing Rules and GEM Listing Rules adopt the phrase "true and fair view".

^{10c} 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".

Date of the Auditor's Report

41. 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. A38-A41)
- (a) All the statements that comprise the financial statements, including the related notes, have been prepared; and
 - (b) Those with the recognized authority^{10a} have asserted that they have taken responsibility for those financial statements.

Auditor's Address

42. The auditor's report shall name the location in the jurisdiction where the auditor practises.

Auditor's Report Prescribed by Law or Regulation

43. 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. A42)
- (a) A title;
 - (b) An addressee, as required by the circumstances of the engagement;
 - (c) An introductory paragraph that identifies the financial statements audited;
 - (d) A description of the responsibility of management (or other appropriate term, see paragraph 24) for the preparation of the financial statements;
 - (e) A description of the auditor's responsibility to express an opinion on the financial statements and the scope of the audit, that includes:
 - A reference to Hong Kong Standards on Auditing and the law or regulation; and
 - A description of an audit in accordance with those standards;
 - (f) An opinion paragraph 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 37);
 - (g) The auditor's signature;
 - (h) The date of the auditor's report; and
 - (i) The auditor's address.

Auditor's Report for Audits Conducted in Accordance with Both Auditing Standards of a Specific Jurisdiction and Hong Kong Standards on Auditing

44. An auditor may be required to conduct an audit in accordance with the auditing standards of a specific jurisdiction ("other auditing standards"), but may additionally have complied with 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. A43-A44)
- (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 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 paragraph 43(a)-(i) when the auditor uses the layout or wording specified by the other auditing standards. Reference to law or regulation in paragraph 43(e) shall be read as reference to the other auditing standards. The auditor's report shall thereby identify such other auditing standards.
45. 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. A45-A51)

46. 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 such supplementary information is clearly differentiated from the audited financial statements. If such supplementary information is not clearly differentiated from the audited financial statements, the auditor shall ask management to change how the unaudited supplementary information is presented. If management refuses to do so, the auditor shall explain in the auditor's report that such supplementary information has not been audited.
47. Supplementary information that is not required by the applicable financial reporting framework but is nevertheless an integral part of the financial statements because it cannot be clearly differentiated from the audited financial statements due to its nature and how it is presented shall be covered by the auditor's opinion.

Conformity and Compliance with International Standards on Auditing

48. As of September 2009 (date of issue), this HKSA conforms with International Standard on Auditing (ISA) 700 "Forming an Opinion and Reporting on Financial Statements". Compliance with the requirements of this HKSA ensures compliance with ISA 700.
49. Additional local explanations are provided in footnotes 10a, 10b, 10c, 14a, 19a, 20a and 21a.
50. Additional local guidance is provided in the Appendix.

Application and Other Explanatory Material

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

- A1. Management makes a number of judgments about the amounts and disclosures in the financial statements.
- A2. HKSA 260 contains a discussion of the qualitative aspects of accounting practices.¹¹ 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 (for example, correcting misstatements with the effect of increasing reported earnings, but not correcting misstatements that have the effect of decreasing reported earnings).
 - Possible management bias in the making of accounting estimates.
- A3. HKSA 540 addresses possible management bias in making accounting estimates.¹² 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.

Disclosure 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.¹³ That description is important because it 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.

¹¹ HKSA 260, "Communication with Those Charged with Governance," Appendix 2.

¹² HKSA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures," paragraph 21.

¹³ HKSA 200, paragraphs A2-A3.

- A7. A description of the applicable financial reporting framework that contains imprecise qualifying or limiting language (for example, “the financial statements are in substantial compliance with Hong Kong Financial Reporting Standards”) is not an adequate description of that framework as it may mislead users of the financial statements.

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 (for example, Hong Kong Financial Reporting Standards 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 (for example, financial statements prepared in accordance with other framework that also describe the extent to which they comply with Hong Kong Financial Reporting Standards). Such description is supplementary financial information and, as discussed in paragraph 47, is considered an integral part of the financial statements and, accordingly, is covered by the auditor’s opinion.

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.¹⁴

Auditor’s Report (Ref: Para. 20)

- A13. A written report encompasses reports issued in hard copy format and those using an electronic medium.
- A14. The Appendix contains illustrations of auditors’ reports on financial statements, incorporating the elements set forth in paragraphs 21-42.

¹⁴ HKSA 210, “Agreeing the Terms of Audit Engagements,” paragraph 6(a).

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," affirms that the auditor has met all of the relevant ethical requirements regarding independence and, therefore, distinguishes the independent auditor's report from reports issued by others.

Addressee (Ref: Para. 22)

- A16. Law or regulation often specifies 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.^{14a}

Introductory Paragraph (Ref: Para. 23)

- A17. The introductory paragraph states, for example, that the auditor has audited the accompanying 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 the date or period covered by each financial statement] and the summary of significant accounting policies and other explanatory information.
- 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.
- A19. 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 include: a balance sheet, an income statement, a statement of changes in equity, a cash flow statement, and a summary of significant accounting policies and other explanatory information. In some jurisdictions additional information might also be considered to be an integral part of the financial statements.

Management's Responsibility for the Financial Statements (Ref: Para. 26)

- A20. 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.¹⁵ 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.

^{14a} In Hong Kong, auditors of a company incorporated under the Hong Kong Companies Ordinance have a statutory duty to make a report to the shareholders of the company on the company's financial statements.

¹⁵ HKSA 200, paragraph 13(j).

- A21. There may be circumstances when it is appropriate for the auditor to add to the description of management's responsibility in paragraph 26 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.
- A22. Paragraph 26 is consistent with the form in which the responsibilities are agreed in the engagement letter or other suitable form of written agreement, as required by HKSA 210.¹⁶ HKSA 210 provides some flexibility 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 management's responsibilities as required by paragraph 26. 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 of paragraph 26 is used.
- A23. 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 315¹⁷), the descriptions in HKSA 210 and in paragraph 26 do not make specific reference to them.

Auditor's Responsibility (Ref: Para. 29-30)

- A24. The auditor's report states that the auditor's responsibility is to express an opinion on the financial statements based on the audit in order to contrast it to management's responsibility for the preparation of the financial statements.
- A25. 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.
- A26. In accordance with HKSA 200, the auditor does not represent compliance with HKSAs in the auditor's report unless the auditor has complied with the requirements of HKSA 200 and all other HKSAs relevant to the audit.¹⁸

Auditor's Opinion (Ref: Para. 35-37)

Wording of the auditor's opinion prescribed by law or regulation

- A27. HKSA 210 explains that, in some cases, law or regulation of the relevant jurisdiction prescribes the wording of the auditor's report (which in particular includes the auditor's opinion) in terms that are significantly different from the requirements of HKSAs. 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.

¹⁶ HKSA 210, paragraph 6(b)(i)-(ii).

¹⁷ HKSA 315, "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment," paragraph 4(c).

¹⁸ HKSA 200, paragraph 20.

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.¹⁹

“Present fairly, in all material respects” or “give a true and fair view”

- A28. 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.

Description of information that the financial statements present

- A29. 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 information that the financial statements are designed to present, for example, in the case of many general purpose frameworks, 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.

Description of the applicable financial reporting framework and how it may affect the auditor's opinion

- A30. 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 ...”

- A31. 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.”^{19a} HKSA 210 deals with circumstances where there are conflicts between the financial reporting standards and the legislative or regulatory requirements.²⁰

- A32. 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 35-36 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

¹⁹ HKSA 210, paragraph 21.

^{19a} For companies incorporated in Hong Kong, the applicable Corporations Act is the Hong Kong Companies Ordinance.

²⁰ HKSA 210, paragraph 18.

accordance with one of the applicable financial reporting frameworks (for example, Hong Kong Financial Reporting Standards) and an opinion that the financial statements are prepared in accordance with the other applicable financial reporting framework (for example, International Financial Reporting Standards). These opinions may be expressed separately or in a single sentence (for example, the financial statements are presented fairly, in all material respects, in accordance with Hong Kong Financial Reporting Standards and International Financial Reporting Standards).

- (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 but a modified opinion given with regard to the other framework in accordance with HKSA 705.

A33. 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. As explained in paragraph A46, such supplementary information is covered by the auditor's opinion as it cannot be clearly differentiated from the financial statements.

- (a) If the disclosure as to the compliance with the other framework is misleading, a modified opinion is expressed in accordance with HKSA 705.
- (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, drawing attention to the disclosure.

Other Reporting Responsibilities (Ref: Para. 38-39)

A34. In some jurisdictions, the auditor may have additional responsibilities to report on other matters that are supplementary to the auditor's responsibility under HKSAs to report on the financial statements. 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. Auditing standards in the specific jurisdiction often provide guidance on the auditor's responsibilities with respect to specific additional reporting responsibilities in that jurisdiction.

A35. In some cases, the relevant law or regulation may require or permit the auditor to report on these other responsibilities within the 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.

A36. These other reporting responsibilities are addressed in a separate section of the auditor's report in order to clearly distinguish them from the auditor's responsibility under HKSAs to report on the financial statements. Where relevant, this section may contain sub-heading(s) that describe(s) the content of the other reporting responsibility paragraph(s).

Signature of the Auditor (Ref: Para. 40)

A37. 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.^{20a}

Date of the Auditor's Report (Ref: Para. 41)

- A38. 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 560.²¹
- A39. 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.
- A40. In some jurisdictions, the law or regulation identifies the individuals or bodies (for example, the directors) that are responsible for concluding that all the statements that comprise the financial statements, including the related notes, have been prepared, and specifies the necessary approval process. In such cases, evidence is obtained of that approval before dating the report on the financial statements. In other jurisdictions, however, the approval process is not prescribed in law or regulation. In such cases, the procedures the entity follows in preparing and finalizing its financial statements in view of its management and governance structures are considered in order to identify the individuals or body with the authority to conclude that all the statements that comprise the financial statements, including the related notes, have been prepared. In some cases, law or regulation identifies the point in the financial statement reporting process at which the audit is expected to be complete.
- A41. 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.^{21a}

^{20a} 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.

²¹ HKSA 560, "Subsequent Events," paragraphs 10-17.

^{21a} 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.

Auditor's Report Prescribed by Law or Regulation (Ref: Para. 43)

- A42. HKSA 200 explains that the auditor may be required to comply with legal or regulatory requirements in addition to HKSAs.²² Where this is the case, the auditor may be obliged to use a layout or wording in the auditor's report that differs from that described in this HKSA. As explained in paragraph 4, 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 and HKSAs relate only to the layout and wording of the auditor's report and, at a minimum, each of the elements identified in paragraph 43(a)(i) are 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 HKSAs, even when the layout and wording used in the auditor's report are specified by legal or regulatory reporting requirements. Where specific requirements in a particular jurisdiction do not conflict with HKSAs, adoption of the layout and wording used in this HKSA assists users of the auditor's report more readily to recognize the auditor's report as a report on an audit conducted in accordance with HKSAs. (HKSA 210 deals with circumstances where law or regulation prescribes the layout or wording of the auditor's report in terms that are significantly different from the requirements of HKSAs.)

Auditor's Report for Audits Conducted in Accordance with Both Auditing Standards of a Specific Jurisdiction and Hong Kong Standards on Auditing (Ref: Para. 44)

- A43. 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 other auditing standards when, in addition to complying with the relevant other auditing standards, the auditor complies with each of HKSAs relevant to the audit.²³
- A44. A reference to both Hong Kong Standards on Auditing and 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 paragraph that, in the particular circumstances, is required by HKSAs. For example, some other auditing standards prohibit the auditor from including an Emphasis of Matter paragraph to highlight a going concern problem, whereas HKSA 570 requires the auditor to add an Emphasis of Matter paragraph in such circumstances.²⁴ 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. 46-47)

- A45. 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 statement items. Such information is normally presented in either supplementary schedules or as additional notes.

²² HKSA 200, paragraph A55.

²³ HKSA 200, paragraph A56.

²⁴ HKSA 570, "Going Concern," paragraph 19.

- A46. The auditor's opinion covers supplementary information that cannot be clearly differentiated from the financial statements because of its nature and how it is presented. For example, this would be the case when the notes to the financial statements include an explanation of the extent to which the financial statements comply with another financial reporting framework. The auditor's opinion would also cover notes or supplementary schedules that are cross-referenced from the financial statements.
- A47. Supplementary information that is covered by the auditor's opinion does not need to be specifically referred to in the introductory paragraph of the auditor's report when the reference to the notes in the description of the statements that comprise the financial statements in the introductory paragraph is sufficient.
- A48. Law or regulation may not require that the supplementary information be audited, and management may decide not to ask the auditor to include the supplementary information within the scope of the audit of the financial statements.
- A49. 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."
- A50. 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 place the unaudited notes together at the end of the required notes to the financial statements and clearly label them as unaudited. Unaudited notes that are intermingled with the audited notes can be misinterpreted as being audited.
- A51. The fact that supplementary information is unaudited does not relieve the auditor of the responsibility to read that information to identify material inconsistencies with the audited financial statements. The auditor's responsibilities with respect to unaudited supplementary information are consistent with those described in HKSA 720.²⁵

²⁵ HKSA 720, "The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements."

Appendix

(Ref: Para. A14)

Illustrations of Auditors' Reports on Financial Statements

- Illustration 1: An auditor's report for a company incorporated in Hong Kong.
- Illustration 2: An auditor's report on financial statements prepared in accordance with a compliance framework designed to meet the common financial information needs of a wide range of users.
- Illustration 3: An auditor's report for a company incorporated in Hong Kong submitting group financial statements.
- Illustration 4: An auditor's report for a company incorporated overseas and reporting in Hong Kong.

Illustration 1:

Circumstances include the following:

- **Audit of a complete set of financial statements.**
- **The financial statements are prepared for a general purpose by directors of the entity in accordance with Hong Kong Financial Reporting Standards.**
- **The terms of the audit engagement reflect description of directors' responsibility for the financial statements in HKSA 210.**
- **In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance.**

INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)^{25a}

[Report on the Financial Statements]²⁶

We have audited the financial statements of ABC Limited ("the Company") set out on pages to, which comprise the [balance sheet][statement of financial position]^{26a} as at 31 December 20X1, and the [income statement][statement of comprehensive income]^{26a}, statement of changes in equity and [cash flow statement][statement of cash flows]^{26a} for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors'²⁷ Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit^{28a}. 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.

^{25a} In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

²⁶ The sub-title "Report on the Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

^{26a} Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

²⁷ Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

²⁸ Not used.

^{28a} Auditor may consider it appropriate to clarify to whom he/ she is 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".

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.³⁰ 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 state of the Company's affairs as at 31 December 20X1, and of its [profit][loss] and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

[Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]²⁶

XYZ & Co.

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

[Auditor's address]

Date of the auditor's report

²⁹ Not used

³⁰ 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:

Circumstances include the following:

- **Audit of a complete set of financial statements required by law or regulation.**
- **The financial statements are prepared for a general purpose by management of the entity in accordance with the Financial Reporting Framework (XYZ Law) of Jurisdiction X (that is, a financial reporting framework, encompassing law or regulation, designed to meet the common financial information needs of a wide range of users, but which is not a fair presentation framework).**
- **The terms of the audit engagement reflect the description of management's responsibility for the financial statements in HKSA 210.**

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

We have audited the financial statements of ABC Limited ("the Company") set out on pages to, which comprise the [balance sheet][statement of financial position]^{30a} as at 31 December 20X1, and the [income statement][statement of comprehensive income]^{30a}, statement of changes in equity and [cash flow statement][statement of cash flows]^{30a} for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's³¹ Responsibility for the Financial Statements

Management is responsible for the preparation of these financial statements in accordance with XYZ Law of Jurisdiction X, and for such internal control as the 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

Our responsibility is to express an opinion on these financial statements based on our audit^{31a}. 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 the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's

^{30a} Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

³¹ Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

^{31a} Auditor may consider it appropriate to clarify to whom he/ she is 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".

internal control.³² 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 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 of the Company for the year ended 31 December 20X1 are prepared, in all material respects, in accordance with XYZ Law of Jurisdiction X.

XYZ & Co.

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

[Auditor's address]

Date of the auditor's report

³² 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 the financial statements in order to design audit procedures that are appropriate in the circumstances."

Illustration 3:

Circumstances include the following:

- **Audit of consolidated financial statements prepared for a general purpose by directors of the parent in accordance with Hong Kong Financial Reporting Standards.**
- **The terms of the group audit engagement reflect the description of directors' responsibility for the financial statements in HKSA 210.**
- **In addition to the audit of the group financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance.**

INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)^{32a}

[Report on the Consolidated Financial Statements]³³

We have audited the consolidated financial statements of ABC Limited ("the Company") and its subsidiaries (together "the Group") set out on pages to, which comprise the consolidated and company [balance sheets][statements of financial position]^{33a} as at 31 December 20X1, and the consolidated [income statement][statement of comprehensive income]^{33a}, the consolidated statement of changes in equity and the consolidated [cash flow statement][statement of cash flows]^{33a} for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors'³⁴ Responsibility for the Consolidated Financial Statements

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 Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit^{35a}. 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

^{32a} In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

³³ The sub-title "Report on the Consolidated Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

^{33a} Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

³⁴ Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

³⁵ Not used.

^{35a} Auditor may consider it appropriate to clarify to whom he/ she is 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".

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 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.³⁷ 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 audit opinion.

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 20X1, and of the Group's [profit][loss] and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

[Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]³³

XYZ & Co.

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

[Auditor's address]

Date of the auditor's report

³⁶ Not used

³⁷ 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."

Illustration 4:

Circumstances include the following:

- **Audit of a complete set of financial statements.**
- **The financial statements are prepared for a general purpose by directors of the entity in accordance with Hong Kong Financial Reporting Standards.**
- **The terms of the audit engagement reflect description of directors' responsibility for the financial statements in HKSA 210.**
- **The entity is incorporated overseas and has reporting in Hong Kong.**

INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF ABC LIMITED

(incorporated in [country or place] with limited liability)³⁸

[Report on the Financial Statements]³⁹

We have audited the financial statements of ABC Limited ("the Company") set out on pages to, which comprise the [balance sheet][statement of financial position]⁴⁰ as at 31 December 20X1, and the [income statement][statement of comprehensive income]⁴⁰, statement of changes in equity and [cash flow statement][statement of cash flows]⁴⁰ for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors' ⁴¹ Responsibility for the Financial Statements

The directors are responsible for the preparation of financial statements that give a true and fair view in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants ⁴² [and the disclosure requirements of the Hong Kong Companies Ordinance ⁴³], 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.

³⁸ In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

³⁹ The sub-title "Report on the Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

⁴⁰ Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

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

⁴² 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.

⁴³ For a company incorporated overseas and listed in Hong Kong, the disclosure requirements of the Hong Kong Companies Ordinance are applicable.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit ⁴⁴. 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 ⁴⁵. 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 state of the Company's affairs as at 31 December 20X1, and of its [profit][loss] and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards [and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance].

[Report on Other Legal and Regulatory Requirements]

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]³⁹

XYZ & Co.

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

[Auditor's address]

Date of the auditor's report

⁴⁴ Auditor may consider it appropriate to clarify to whom he/ she is 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".

⁴⁵ 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."

HKSA 705
Issued September 2009

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

Hong Kong Standard on Auditing 705

Modifications to the Opinion in the Independent Auditor's Report



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

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HONG KONG STANDARD ON AUDITING 705
MODIFICATIONS TO THE OPINION IN THE INDEPENDENT
AUDITOR'S REPORT

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

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Hong Kong Standard on Auditing (HKSA) 705, "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 700,¹ the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary.

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 beginning on or after 15 December 2009.

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:
 - (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

¹ HKSA 700, "Forming an Opinion and Reporting on Financial Statements."

- (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.

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, 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-A14)
 - (ii) If withdrawal from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial statements.
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 report³ in these circumstances would contradict the auditor's adverse opinion or disclaimer of opinion on the financial statements as a whole. (Ref: Para. A16)

² HKSA 260, "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

Basis for Modification Paragraph

16. When the auditor modifies the opinion on the financial statements, the auditor shall, in addition to the specific elements required by HKSA 700, include a paragraph in the auditor's report that provides a description of the matter giving rise to the modification. The auditor shall place this paragraph immediately before the opinion paragraph in the auditor's report and use the heading "Basis for Qualified Opinion," "Basis for Adverse Opinion," or "Basis for Disclaimer of Opinion," as appropriate. (Ref: Para. A17)
17. If there is a material misstatement of the financial statements that relates to specific amounts in the financial statements (including quantitative disclosures), the auditor shall include in the basis for modification paragraph 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 the basis for modification paragraph. (Ref: Para. A18)
18. If there is a material misstatement of the financial statements that relates to narrative disclosures, the auditor shall include in the basis for modification paragraph an explanation of how the disclosures are misstated.
19. 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 modification paragraph 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. A19)
20. If the modification results from an inability to obtain sufficient appropriate audit evidence, the auditor shall include in the basis for modification paragraph the reasons for that inability.
21. 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 modification paragraph 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. A20)

Opinion Paragraph

22. 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 paragraph. (Ref: Para. A21, A23-A24)
23. When the auditor expresses a qualified opinion due to a material misstatement in the financial statements, the auditor shall state in the opinion paragraph that, in the auditor's opinion, except for the effects of the matter(s) described in the Basis for Qualified Opinion paragraph:
 - (a) The financial statements present fairly, in all material respects (or give a true and fair view) in accordance with the applicable financial reporting framework when reporting in accordance with a fair presentation framework; or

- (b) The financial statements have been prepared, in all material respects, in accordance with the applicable financial reporting framework when reporting in accordance with a compliance 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. A22)

- 24. When the auditor expresses an adverse opinion, the auditor shall state in the opinion paragraph that, in the auditor’s opinion, because of the significance of the matter(s) described in the Basis for Adverse Opinion paragraph:
 - (a) The financial statements do not present fairly (or give a true and fair view) in accordance with the applicable financial reporting framework when reporting in accordance with a fair presentation framework; or
 - (b) The financial statements have not been prepared, in all material respects, in accordance with the applicable financial reporting framework when reporting in accordance with a compliance framework.
- 25. When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor shall state in the opinion paragraph that:
 - (a) Because of the significance of the matter(s) described in the Basis for Disclaimer of Opinion paragraph, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion; and, accordingly,
 - (b) The auditor does not express an opinion on the financial statements.

Description of Auditor’s Responsibility When the Auditor Expresses a Qualified or Adverse Opinion

- 26. When the auditor expresses a qualified or adverse opinion, the auditor shall amend the description of the auditor’s responsibility to state that the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor’s modified audit opinion.

Description of Auditor’s Responsibility When the Auditor Disclaims an Opinion

- 27. When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence, the auditor shall amend the introductory paragraph of the auditor’s report to state that the auditor was engaged to audit the financial statements. The auditor shall also amend the description of the auditor’s responsibility and the description of the scope of the audit to state only the following: “Our responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with Hong Kong Standards on Auditing. Because of the matter(s) described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.”^{3a}

^{3a} In Hong Kong, an auditor of a company incorporated under the Hong Kong Companies Ordinance has a statutory duty to make a report to the members of the company on the company’s annual financial statements. Accordingly, an auditor in Hong Kong adheres to the requirements under paragraphs 29 and 30 of HKSA 700 which require that the auditor’s report should state the auditor’s responsibility and give details of the basis of an audit. Illustrations 4 and 5 of the Appendix reflect the auditor’s duty under the Hong Kong Companies Ordinance.

Communication with Those Charged with Governance

28. 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 proposed wording of the modification. (Ref: Para. A25)

Conformity and Compliance with International Standards on Auditing

29. As of September 2009 (date of issue), this HKSA conforms with International Standard on Auditing (ISA) 705 "Modifications to the Opinion in the Independent Auditor's Report" except for the different wording in the description of auditor's responsibility when the auditor disclaims an opinion in paragraph 27 due to the Hong Kong statutory requirement. With the exception of the foregoing difference, as explained in footnote 3a, compliance with the requirements of this HKSA ensures compliance with ISA 705.
30. Additional local guidance is provided in footnote 3a and Appendix.

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.

<i>Nature of Matter Giving Rise to the Modification</i>	<i>Auditor's Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements</i>	
	<i>Material but Not Pervasive</i>	<i>Material and Pervasive</i>
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

Nature of Material Misstatements (Ref: Para. 6(a))

- A2. HKSA 700 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.⁴ This conclusion takes into account the auditor's evaluation of uncorrected misstatements, if any, on the financial statements in accordance with HKSA 450.⁵

⁴ HKSA 700, paragraph 11.

⁵ HKSA 450, "Evaluation of Misstatements Identified during the Audit," paragraph 4(a).

- 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
 - (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 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.

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)-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 in the Basis for Disclaimer of Opinion paragraph 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.⁶
- 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.⁷
 - 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 510.⁸). 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

Basis for Modification Paragraph (Ref: Para. 16-17, 19, 21)

- A17. 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 basis for the modification may not be possible, consistency in both the form and content of the auditor's report is desirable.
- A18. An example of the financial effects of material misstatements that the auditor may describe in the basis for modification paragraph 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.
- A19. Disclosing the omitted information in the basis for modification paragraph 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.

⁶ HKSA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report," paragraph A5.

⁷ See paragraph A32 of HKSA 700 for a description of this circumstance.

⁸ HKSA 510, "Initial Audit Engagements—Opening Balances," paragraph 10.

- A20. An adverse opinion or a disclaimer of opinion relating to a specific matter described in the basis for qualification paragraph 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.

Opinion Paragraph (Ref: Para. 22-23)

- A21. Inclusion of this paragraph heading makes it clear to the user that the auditor's opinion is modified and indicates the type of modification.
- A22. 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 paragraph as these are not sufficiently clear or forceful.

Illustrative Auditors' Reports

- A23. Illustrations 1 and 2 in the Appendix contain auditors' reports with qualified and adverse opinions, respectively, as the financial statements are materially misstated.
- A24. 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.

Communication with Those Charged with Governance (Ref: Para. 28)

- A25. Communicating with those charged with governance the circumstances that lead to an expected modification to the auditor's opinion and the proposed 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. A23-24)

Illustrations of Auditors' 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 financial statements.
- Illustration 3: An auditor's report containing a qualified opinion due to the auditor's inability to obtain sufficient appropriate audit evidence.
- 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 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:

Circumstances include the following:

- **Audit of a complete set of general purpose financial statements prepared by the directors of the entity in accordance with Hong Kong Financial Reporting Standards.**
- **The terms of the audit engagement reflect the description of directors' responsibility for the financial statements in HKSA 210.⁹**
- **Inventories are misstated. The misstatement is deemed to be material but not pervasive to 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 SHAREHOLDERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)^{9a}

[Report on the Financial Statements]¹⁰

We have audited the financial statements of ABC Limited (the "Company") set out on pages to, which comprise the [balance sheet][statement of financial position]^{10a} as at 31 December 20X1, and the [income statement][statement of comprehensive income]^{10a}, statement of changes in equity and [cash flow statement][statement of cash flows]^{10a} for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors'¹¹ Responsibility for the Financial Statements

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

⁹ HKSA 210, "Agreeing the Terms of Audit Engagements."

^{9a} In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

¹⁰ The sub-title "Report on the Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

^{10a} Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

¹¹ Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

¹² Not used.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit ^{12a}. 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.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 qualified audit opinion.

Basis for Qualified Opinion

The Company's inventories are carried in the [balance sheet][statement of financial position]^{10a} 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 Hong Kong Financial Reporting Standards. 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.

Qualified Opinion

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

^{12a} Auditor may consider it appropriate to clarify to whom he/ she is 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.

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 Other Legal and Regulatory Requirements]

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]¹⁰

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:

- **Audit of consolidated general purpose financial statements prepared by the directors of the parent in accordance with Hong Kong Financial Reporting Standards.**
- **The terms of the audit engagement reflect the description of directors' responsibility for the financial statements in HKSA 210.**
- **The financial statements are materially misstated due to the non-consolidation of a subsidiary. The material misstatement is deemed to be pervasive to the financial statements. The effects of the misstatement on the financial statements have not been determined because it was not practicable to do so.**
- **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 Hong Kong Companies Ordinance on non-consolidation of a subsidiary.**

INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)^{14a}

[Report on the Consolidated Financial Statements]¹⁵

We have audited the consolidated financial statements of ABC Limited (the "Company") and its subsidiaries (together "the Group") set out on pages to, which comprise the consolidated and company [balance sheets][statements of financial position]^{15a} as at 31 December 20X1, and the consolidated [income statement][statement of comprehensive income]^{15a}, the consolidated statement of changes in equity and the consolidated [cash flow statement][statement of cash flows]^{15a} for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors'¹⁶ Responsibility for the Consolidated Financial Statements

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.

^{14a} In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

¹⁵ The sub-title "Report on the Consolidated Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

^{15a} Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

¹⁶ Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

¹⁷ Not used.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit^{17a}. 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 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.¹⁹ 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 adverse audit opinion.

Basis for Adverse Opinion

As explained in Note X, the Company has not consolidated the financial statements of subsidiary DEF Limited it acquired during 20X1 because it has not yet been able to ascertain the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This investment is therefore accounted for on a cost basis. Under Hong Kong Financial Reporting Standards, the subsidiary should have been consolidated because it is controlled by the Company. Had DEF been consolidated, many elements in the financial statements would have been materially affected. The effects on the consolidated financial statements of the failure to consolidate have not been determined.

Adverse Opinion

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion paragraph, the consolidated financial statements do not give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 20X1, and of the Group's [profit][loss] and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards. In all other respects, in our opinion the consolidated financial statements have been properly prepared in accordance with the Hong Kong Companies Ordinance.^{19a}

^{17a} Auditor may consider it appropriate to clarify to whom he/ she is 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".

¹⁸ Not used.

¹⁹ 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."

^{19a} Assume the consolidated financial statements have been properly prepared in accordance with the Hong Kong Companies Ordinance in all other respects.

[Report on Other Legal and Regulatory Requirements]

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]¹⁵

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:

- **Audit of a complete set of general purpose financial statements prepared by the directors of the entity in accordance with Hong Kong Financial Reporting Standards.**
- **The terms of the audit engagement reflect the description of directors' responsibility for the financial statements in HKSA 210.**
- **The auditor was unable to obtain sufficient appropriate audit evidence regarding an investment in a foreign affiliate. The possible effects of the inability to obtain sufficient appropriate audit evidence are deemed to be material but not pervasive to 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.**

INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)^{19b}

Report on the Financial Statements

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

Directors'²¹ Responsibility for the Financial Statements

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

^{19b} In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

²⁰ Not used.

^{20a} Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

²¹ Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

²² Not used.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit^{22a}. 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.²⁴ 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

ABC Limited'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 [balance sheet][statement of financial position]^{20a} 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.

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 state of the Company's affairs as at 31 December 20X1, and of its [profit][loss] and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

^{22a} Auditor may consider it appropriate to clarify to whom he/ she is 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".

²³ Not used.

²⁴ 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 matters under sections 141(4) and 141(6) of the Hong Kong Companies Ordinance ^{24a}

In respect alone of the inability to obtain sufficient appropriate audit evidence regarding an investment in a foreign associate:

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

XYZ & Co.

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

[Auditor's address]

Date of the auditor's report

^{24a} 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".

Illustration 4:

Circumstances include the following:

- **Audit of a complete set of general purpose financial statements prepared by the directors of the entity in accordance with Hong Kong Financial Reporting Standards.**
- **The terms of the audit engagement reflect the description of directors' responsibility for the financial statements in HKSA 210.**
- **The auditor was unable to obtain sufficient appropriate audit evidence about a single element of the 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 company'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 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.**

INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)^{24b}

Report on the Financial Statements

We were engaged to audit the financial statements of ABC Limited ("the Company") set out on pages to, which comprise the [balance sheet][statement of financial position]^{25a} as at 31 December 20X1, and the [income statement][statement of comprehensive income]^{25a}, statement of changes in equity and [cash flow statement][statement of cash flows]^{25a} for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors'²⁶ Responsibility for the Financial Statements

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

^{24b} In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

²⁵ Not used.

^{25a} Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

²⁶ Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

²⁷ Not used.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit ^{27a}. Except for the inability to obtain sufficient appropriate audit evidence as explained below, we conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.^{3a} Because of the matter described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

The Company's investment in its joint venture DEF (Country X) Limited is carried at xxx on the Company's [balance sheet][statement of financial position]^{25a}, which represents over 90% of the Company's net assets as at 31 December 20X1. We were not allowed access to the management and the auditors of DEF, including DEF's auditors' audit documentation. As a result, we were unable to determine whether any adjustments were necessary in respect of the Company's proportional share of DEF's assets that it controls jointly, its proportional share of DEF'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 statement of changes in equity and [cash flow statement][statement of cash flows].^{25a}

Disclaimer of Opinion

Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statements. In all other respects, in our opinion the financial statements have been properly prepared in accordance with the Hong Kong Companies Ordinance.

Report on matters under sections 141(4) and 141(6) of the Hong Kong Companies Ordinance
^{27b}

In respect alone of the inability to obtain sufficient appropriate audit evidence regarding an investment in a joint venture:

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

XYZ & Co.

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

[Auditor's address]

Date of the auditor's report

^{27a} Auditor may consider it appropriate to clarify to whom he/ she is 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".

^{27b} 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".

Illustration 5:

Circumstances include the following:

- **Audit of a complete set of general purpose financial statements prepared by the directors of the entity in accordance with Hong Kong Financial Reporting Standards.**
- **The terms of the audit engagement reflect the description of directors' responsibility for the financial statements in HKSA 210.**
- **The auditor was unable to obtain sufficient appropriate audit evidence about multiple elements of the financial statements. That is, the auditor was 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.**
- **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.**

INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)^{27c}

Report on the Financial Statements

We were engaged to audit the financial statements of ABC Limited ("the Company") set out on pages to, which comprise the [balance sheet][statement of financial position]^{28a} as at 31 December 20X1, and the [income statement][statement of comprehensive income]^{28a}, statement of changes in equity and [cash flow statement][statement of cash flows]^{28a} for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors'²⁹ Responsibility for the Financial Statements

The directors are responsible for the preparation of financial statements that give a true and fair view in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified 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.

^{27c} In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

²⁸ Not used.

^{28a} Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

²⁹ Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

³⁰ Not used.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit^{30a}. Except for the inability to obtain sufficient appropriate audit evidence as explained below, we conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.^{3a} Because of the matters described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

We were 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 [balance sheet][statement of financial position]^{28a} 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 audit report, the directors were 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 [balance sheet][statement of financial position]^{28a} 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 [income statement][statement of comprehensive income]^{28a}, statement of changes in equity and [cash flow statement][statement of cash flows].^{28a}

Disclaimer of Opinion

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the financial statements. In all other respects, in our opinion the financial statements have been properly prepared in accordance with the Hong Kong Companies Ordinance.

Report on matters under sections 141 (4) and 141 (6) of the Hong Kong Companies Ordinance^{30b}

In respect alone of the inability to obtain sufficient appropriate audit evidence about the inventories and accounts receivable:

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

XYZ & Co.

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

[Auditor's address]

Date of the auditor's report

^{30a} Auditor may consider it appropriate to clarify to whom he/ she is 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".

^{30b} 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".

HKSA 706
Issued September 2009

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

Hong Kong Standard on Auditing 706

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



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HONG KONG STANDARD ON AUDITING 706

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

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

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

Introduction

Scope of this HKSA

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

Effective Date

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

Objective

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

Definitions

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

Requirements

Emphasis of Matter Paragraphs in the Auditor's Report

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

Other Matter Paragraphs in the Auditor's Report

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

Communication with Those Charged with Governance

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

Conformity and Compliance with International Standards on Auditing

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

Application and Other Explanatory Material

Emphasis of Matter Paragraphs in the Auditor's Report

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

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

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

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

Other Matter Paragraphs in the Auditor's Report (Ref: Para. 8)

Circumstances in Which an Other Matter Paragraph May Be Necessary

Relevant to Users' Understanding of the Audit

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

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

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

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

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

Reporting on more than one set of financial statements

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

Restriction on distribution or use of the auditor's report

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

Including an Other Matter Paragraph in the Auditor's Report

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

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

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

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

Appendix 1

(Ref: Para. 2)

List of HKSAs Containing Requirements for Emphasis of Matter Paragraphs

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

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

Appendix 2

(Ref: Para. 2)

List of HKSAs Containing Requirements for Other Matter Paragraphs

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

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

Appendix 3

(Ref: Para. A4)

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

Circumstances include the following:

- **Audit of a complete set of general purpose financial statements prepared by the directors of the entity in accordance with Hong Kong Financial Reporting Standards.**
- **The terms of the audit engagement reflect the description of directors' responsibility for the financial statements in HKSA 210.⁴**
- **There is uncertainty relating to a pending exceptional litigation matter.**
- **A departure from the applicable financial reporting framework resulted in a qualified opinion.**
- **In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under local law in addition to the Hong Kong Companies Ordinance.**

INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)^{4a}

[Report on the Financial Statements]⁵

We have audited the financial statements of ABC Limited ("the Company") set out on pages to, which comprise the [balance sheet][statement of financial position]^{5a} as at 31 December 20X1, and the [income statement][statement of comprehensive income]^{5a}, statement of changes in equity and [cash flow statement][statement of cash flows]^{5a} for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors'⁶ Responsibility for the Financial Statements

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

⁴ HKSA 210, "Agreeing the Terms of Audit Engagements."

^{4a} In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

⁵ The subtitle "Report on the Financial Statements" is unnecessary in circumstances when the second subtitle "Report on Other Legal and Regulatory Requirements" is not applicable.

^{5a} Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

⁶ Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

⁷ Not used.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit ^{7a}. 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.⁹ An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

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

Basis for Qualified Opinion

The Company's short-term marketable securities are carried in the [balance sheet][statement of financial position]^{5a} at xxx. The directors have not marked these securities to market but have instead stated them at cost, which constitutes a departure from Hong Kong Financial Reporting Standards. The Company's records indicate that had the directors marked the marketable securities to market, the Company would have recognized an unrealized loss of xxx in the [income statement][statement of comprehensive income]^{5a} for the year. The carrying amount of the securities in the [balance sheet][statement of financial position]^{5a} would have been reduced by the same amount at 31 December 20X1, and income tax, net income and shareholders' equity would have been reduced by xxx, xxx and xxx, respectively.

Qualified Opinion

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

Emphasis of Matter

We draw attention to Note X to the financial statements which describes the uncertainty ¹⁰ related to the outcome of the lawsuit filed against the Company by DEF Company. Our opinion is not qualified in respect of this matter.

^{7a} Auditor may consider it appropriate to clarify to whom he/ she is 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".

⁸ Not used.

⁹ 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."

¹⁰ In highlighting the uncertainty, the auditor uses the same terminology that is used in the note to the financial statements.

[Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]]⁵

XYZ & Co.

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

[Auditor's address]

Date of the auditor's report

HKSA 710
Issued September 2009

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



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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)

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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."
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Introduction

Scope of this HKSA

1. This Hong Kong Standard on Auditing (HKSA) deals with the auditor's responsibilities relating to 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 510¹ 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.

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)

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

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 706.⁵ (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

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.

⁵ HKSA 706, "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.

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:

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.

Appendix 1

Illustrations of Auditors' Reports

Illustration 1 - Corresponding Figures (Ref: Para. A5)

Report illustrative of the circumstances described in paragraph 11(a), as follows:

- 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.

INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)^{7a}

[Report on the Financial Statements]⁸

We have audited the financial statements of ABC Limited ("the Company") set out on pages to, which comprise the [balance sheet][statement of financial position]^{8a} as at 31 December 20X1, and the [income statement][statement of comprehensive income]^{8a}, statement of changes in equity and [cash flow statement][statement of cash flows]^{8a} for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors'⁹ Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit ^{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.

^{7a} In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

⁸ The sub-title "Report on the Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

^{8a} Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

⁹ Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

¹⁰ Not used.

^{10a} Auditor may consider it appropriate to clarify to whom he/ she is 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".

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.¹² 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.

Qualified Opinion

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

[Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]]⁸

XYZ & Co.

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

[Auditor's address]

Date of the auditor's report

¹¹ Not used.

¹² 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 - Corresponding Figures (Ref: Para. A5)

Report illustrative of the circumstances described in paragraph 11(b), as follows:

- **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.**

INDEPENDENT AUDITOR’S REPORT

TO THE SHAREHOLDERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)^{12a}

[Report on the Financial Statements]¹³

We have audited the financial statements of ABC Limited (“the Company”) set out on pages to, which comprise the [balance sheet][statement of financial position]^{13a} as at 31 December 20X1, and the [income statement][statement of comprehensive income],^{13a} statement of changes in equity and [cash flow statement][statement of cash flows]^{13a} for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors’¹⁴ Responsibility for the Financial Statements

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

Auditor’s Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit^{15a}. 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.

^{12a} In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

¹³ The sub-title “Report on the Financial Statements” is unnecessary in circumstances when the second sub-title “Report on Other Legal and Regulatory Requirements” is not applicable.

^{13a} Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

¹⁴ Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

¹⁵ Not used.

^{15a} Auditor may consider it appropriate to clarify to whom he/ she is 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”.

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.¹⁷ 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 state of the Company's affairs as at 31 December 20X1, and of its [profit][loss] and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

[Report on Other Legal and Regulatory Requirements]

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]¹³

XYZ & Co.

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

[Auditor's address]

Date of the auditor's report

¹⁶ Not used.

¹⁷ 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 3 - Corresponding Figures: (Ref: Para. A7)

Report illustrative of the circumstances described in paragraph 13, as follows:

- **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.**

INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF ABC LIMITED

(incorporated in Hong Kong with limited liability)^{17a}

[Report on the Financial Statements]¹⁸

We have audited the financial statements of ABC Limited ("the Company") set out on pages to, which comprise the [balance sheet][statement of financial position]^{18a} as at 31 December 20X1, and the [income statement][statement of comprehensive income]^{18a}, statement of changes in equity and [cash flow statement][statement of cash flows]^{18a} for the year then ended, and a summary of significant accounting policies and other explanatory information.

Directors'¹⁹ Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit^{20a}. 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.

^{17a} In Hong Kong, it is a common practice to disclose the place of incorporation of the company.

¹⁸ The sub-title "Report on the Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

^{18a} Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

¹⁹ Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

²⁰ Not used.

^{20a} Auditor may consider it appropriate to clarify to whom he/ she is 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".

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.²² 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 state of the Company's affairs as at 31 December 20X1, and of its [profit][loss] and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

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

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]¹⁸

XYZ & Co.

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

[Auditor's address]

Date of the auditor's report

²¹ Not used.

²² 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^{22a}: (Ref: Para. A9)

Report illustrative of the circumstances described in paragraph 15, as follows:

- **Auditor 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.**

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

[Report on the Financial Statements]²³

We have audited the financial statements of ABC Limited ("the Company") set out on pages to, which comprise the [balance sheet][statements of financial position]^{23a} as at 31 December 20X1 and 20X0, and the [income statement][statements of comprehensive income]^{23a}, statements of changes in equity and [cash flow statement][statements of cash flows]^{23a} for the years then ended, and a summary of significant accounting policies and other explanatory information.

*Management's*²⁴ *Responsibility for the Financial Statements*

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

Our responsibility is to express an opinion on these financial statements based on our audits^{25a}. We conducted our audits 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.

^{22a} 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.

²³ The sub-title "Report on the Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

^{23a} Delete as appropriate, different terms may be used as long as they are consistent with the titles of the corresponding statements.

²⁴ Or other term that is appropriate in the context of the legal framework in the particular jurisdiction.

²⁵ Not used.

^{25a} Auditor may consider it appropriate to clarify to whom he/ she is 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".

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.²⁷ 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 state of the Company's affairs as at 31 December 20X1 and 20X0 and of its [profit][loss] and cash flows for the years then ended in accordance with Hong Kong Financial Reporting Standards.

[Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]²³

XYZ & Co.

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

[Auditor's address]

Date of the auditor's report

²⁶ Not used.

²⁷ 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 corresponding amounts for most items in a company's balance sheet and profit and loss account. Paragraphs 12(16) and 17(5) of the Tenth Schedule to the Companies Ordinance require that corresponding amounts should be disclosed in respect of every item shown in a company's balance sheet (other than for the movements in fixed assets and reserves) and profit and loss account for the financial year immediately preceding that to which the balance sheet or profit and loss account relates.
- (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) "Corresponding amounts" referred to by the Companies Ordinance and the "comparative figures" referred to by the Main Board Rules and GEM Rules are both referring 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-A11 is, therefore, not generally applicable to an audit performed on a Hong Kong incorporated company's annual statutory financial statements in accordance with HKSAs.

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

Hong Kong Standard on Auditing 720

The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements



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

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HONG KONG STANDARD ON AUDITING 720

**THE AUDITOR'S RESPONSIBILITIES RELATING TO OTHER INFORMATION IN
DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS**

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

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Hong Kong Standard on Auditing (HKSA) 720, "The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited 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 other information in documents containing audited financial statements and the auditor's report thereon. In the absence of any separate requirement in the particular circumstances of the engagement, the auditor's opinion does not cover other information and the auditor has no specific responsibility for determining whether or not other information is properly stated. However, the auditor reads the other information because the credibility of the audited financial statements may be undermined by material inconsistencies between the audited financial statements and other information. (Ref: Para. A1)
2. In this HKSA "documents containing audited financial statements" refers to annual reports (or similar documents), that are issued to owners (or similar stakeholders), containing audited financial statements and the auditor's report thereon. This HKSA may also be applied, adapted as necessary in the circumstances, to other documents containing audited financial statements, such as those used in securities offerings.¹ (Ref: Para. A2)

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 respond appropriately when documents containing audited financial statements and the auditor's report thereon include other information that could undermine the credibility of those financial statements and the auditor's report.

Definitions

5. For purposes of the HKSAs the following terms have the meanings attributed below:
 - (a) Other information – Financial and non-financial information (other than the financial statements and the auditor's report thereon) which is included, either by law, regulation or custom, in a document containing audited financial statements and the auditor's report thereon. (Ref: Para. A3-A4)
 - (b) Inconsistency – Other information that contradicts information contained in the audited financial statements. A material inconsistency may raise doubt about the audit conclusions drawn from audit evidence previously obtained and, possibly, about the basis for the auditor's opinion on the financial statements.
 - (c) Misstatement of fact – Other information that is unrelated to matters appearing in the audited financial statements that is incorrectly stated or presented. A material misstatement of fact may undermine the credibility of the document containing audited financial statements.

¹ 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.

Requirements

Reading Other Information

6. The auditor shall read the other information to identify material inconsistencies, if any, with the audited financial statements.
7. The auditor shall make appropriate arrangements with management or those charged with governance to obtain the other information prior to the date of the auditor's report. If it is not possible to obtain all the other information prior to the date of the auditor's report, the auditor shall read such other information as soon as practicable. (Ref: Para. A5)

Material Inconsistencies ^{1a}

8. If, on reading the other information, the auditor identifies a material inconsistency, the auditor shall determine whether the audited financial statements or the other information needs to be revised.

Material Inconsistencies Identified in Other Information Obtained Prior to the Date of the Auditor's Report

9. If revision of the audited financial statements is necessary and management refuses to make the revision, the auditor shall modify the opinion in the auditor's report in accordance with HKSA 705.²
10. If revision of the other information is necessary and management refuses to make the revision, the auditor shall communicate this matter to those charged with governance, unless all of those charged with governance are involved in managing the entity;³ and
 - (a) Include in the auditor's report an Other Matter(s) paragraph describing the material inconsistency in accordance with HKSA 706;⁴ or
 - (b) Withhold the auditor's report; or
 - (c) Withdraw from the engagements, where withdrawal is possible under applicable law or regulation. (Ref: Para. A6-A7)

Material Inconsistencies Identified in Other Information Obtained Subsequent to the Date of the Auditor's Report

11. If revision of the audited financial statements is necessary, the auditor shall follow the relevant requirements in HKSA 560.⁵
12. If revision of the other information is necessary and management agrees to make the revision, the auditor shall carry out the procedures necessary under the circumstances. (Ref: Para. A8)

^{1a} Additional local guidance is provided in Appendix.

² HKSA 705, "Modifications to the Opinion in the Independent Auditor's Report."

³ HKSA 260, "Communication with Those Charged with Governance," paragraph 13.

⁴ HKSA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report," paragraph 8.

⁵ HKSA 560, "Subsequent Events," paragraphs 10-17.

13. If revision of the other information is necessary, but management refuses to make the revision, the auditor shall notify those charged with governance, unless all of those charged with governance are involved in managing the entity, of the auditor's concern regarding the other information and take any further appropriate action.^{1a} (Ref: Para. A9)

Material Misstatements of Fact

14. If, on reading the other information for the purpose of identifying material inconsistencies, the auditor becomes aware of an apparent material misstatement of fact, the auditor shall discuss the matter with management. (Ref: Para. A10)
15. If, following such discussions, the auditor still considers that there is an apparent material misstatement of fact, the auditor shall request management to consult with a qualified third party, such as the entity's legal counsel, and the auditor shall consider the advice received.
16. If the auditor concludes that there is a material misstatement of fact in the other information which management refuses to correct, the auditor shall notify those charged with governance, unless all of those charged with governance are involved in managing the entity, of the auditor's concern regarding the other information and take any further appropriate action.^{1a} (Ref: Para. A11)

Conformity and Compliance with International Standards on Auditing

17. As of September 2009 (date of issue), this HKSA conforms with International Standard on Auditing (ISA) 720 "The Auditor's Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements". Compliance with the requirements of this HKSA ensures compliance with ISA 720.
18. Additional local guidance is provided in Appendix.

Application and Other Explanatory Material

Scope of this HKSA

Additional Responsibilities, through Statutory or Other Regulatory Requirements, in Relation to Other Information (Ref: Para. 1)

- A1. The auditor may have additional responsibilities, through statutory or other regulatory requirements, in relation to other information that are beyond the scope of this HKSA. For example, some jurisdictions may require the auditor to apply specific procedures to certain of the other information such as required supplementary data or to express an opinion on the reliability of performance indicators described in the other information. Where there are such obligations, the auditor's additional responsibilities are determined by the nature of the engagement and by law, regulation and professional standards. If such other information is omitted or contains deficiencies, the auditor may be required by law or regulation to refer to the matter in the auditor's report.

Documents Containing Audited Financial Statements (Ref: Para. 2)

Considerations Specific to Smaller Entities

- A2. Unless required by law or regulation, smaller entities are less likely to issue documents containing audited financial statements. However, an example of such a document would be where a legal requirement exists for an accompanying report by those charged with governance. Examples of other information that may be included in a document containing the audited financial statements of a smaller entity are a detailed income statement and a management report.

Definition of Other Information (Ref: Para. 5(a))

- A3. Other information may comprise, for example:
- A report by management or those charged with governance on operations.
 - Financial summaries or highlights.
 - Employment data.
 - Planned capital expenditures.
 - Financial ratios.
 - Names of officers and directors.
 - Selected quarterly data.
- A4. For purposes of the HKSA's, other information does not encompass, for example:
- A press release or a transmittal memorandum, such as a covering letter, accompanying the document containing audited financial statements and the auditor's report thereon.
 - Information contained in analyst briefings.
 - Information contained on the entity's website.

Reading Other Information (Ref: Para. 7)

- A5. Obtaining the other information prior to the date of the auditor's report enables the auditor to resolve possible material inconsistencies and apparent material misstatements of fact with management on a timely basis. An agreement with management as to when the other information will be available may be helpful.

Material Inconsistencies

Material Inconsistencies Identified in Other Information Obtained Prior to the Date of the Auditor's Report (Ref: Para. 10)

- A6. When management refuses to revise the other information, the auditor may base any decision on what further action to take on advice from the auditor's legal counsel.

Considerations Specific to Public Sector Entities

- A7. In the public sector, withdrawal from the engagement or withholding the auditor's report may not be options. In such cases, the auditor may issue a report to the appropriate statutory body giving details of the inconsistency.

Material Inconsistencies Identified in Other Information Obtained Subsequent to the Date of the Auditor's Report (Ref: Para. 12-13)

- A8. When management agrees to revise the other information, the auditor's procedures may include reviewing the steps taken by management to ensure that individuals in receipt of the previously issued financial statements, the auditor's report thereon, and the other information are informed of the revision.
- A9. When management refuses to make the revision of such other information that the auditor concludes is necessary, appropriate further actions by the auditor may include obtaining advice from the auditor's legal counsel.

Material Misstatements of Fact (Ref: Para. 14-16)

- A10. When discussing an apparent material misstatement of fact with management, the auditor may not be able to evaluate the validity of some disclosures included within the other information and management's responses to the auditor's inquiries, and may conclude that valid differences of judgment or opinion exist.
- A11. When the auditor concludes that there is a material misstatement of fact that management refuses to correct, appropriate further actions by the auditor may include obtaining advice from the auditor's legal counsel.

Appendix

Additional Local Guidance on Material Inconsistencies and Misstatements of Fact

Auditor's Possible Further Courses of Action (Ref: Para. 8 –16)

1. The auditor has regard to the nature of the inconsistency between the financial statements and the other information or the misstatement of fact in the other information that in his opinion exists. A distinction may be drawn between a matter of fact and one of judgment. It is generally more difficult for the auditor to take issue with a matter of judgment (such as management's view of the likely out-turn for the following year) than a factual error. Although the auditor does not substitute his judgment for that of management in such matters, there may be circumstances in which auditor is aware that the expressed view of management is significantly at variance with the entity's internal assessment or is so unreasonable as not to be credible to someone with the auditor's knowledge. The courses of action to be taken by auditor will depend on the auditor's perception of the seriousness of the inconsistency between the financial statements and the other information or the misstatement of fact.
2. The auditor who is considering the course of including a paragraph after the audit opinion in the auditor's report describing the material inconsistency between the financial statements and the other information or the material misstatement of fact in the other information 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 which appear to be misleading. 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 141(7) of the Companies Ordinance. The auditor would also bear in mind the provisions of section 140A of the Companies Ordinance, and in particular the obligation imposed by subsection (2) thereof, before deciding whether resignation from the engagement would be likely to resolve the problem. The auditor would consider seeking legal advice both as to which course of action he would adopt and as to the precise form of any wording to be used.

Material Inconsistencies (Ref: Para. 10 and Para. 13)

3. When management refuses to revise the other information, the auditor's possible further course of action may involve using his right under section 141(7) of the Companies Ordinance to be heard at any general meeting of the members on any business of the meeting which concerns him as auditor.

Material Misstatements of Fact (Ref: Para. 16)

4. If an amendment is necessary in the other information and the entity refuses to make the amendment, the auditor's possible further courses of action may involve the following:
 - (a) including a paragraph after the audit opinion in the auditor's report describing the material misstatement of fact in the other information;
 - (b) using his right under section 141(7) of the Companies Ordinance to be heard at any general meeting of the members on any business of the meeting which concerns him as auditor;
 - (c) withdrawing from the engagement.