



Hong Kong Institute of
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SMP Forum

Thursday, 8 October 2009

Update to Clarified Pronouncements on Auditing (Clarity Project)

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Agenda

- **Part 1 – Background**

(Presented by Chris Joy)

- **Part 2 - Key changes of revised and redrafted HKSAs**

(Presented by Steve Ong)

- **Part 3 - Support Events and Facilities**

(Presented by Chris Joy)



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Part 1

BACKGROUND

Presented by

Chris Joy
Executive Director
Hong Kong Institute of CPAs



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1. Background

- The policy of convergence of Hong Kong Standards on Auditing (HKSA) with International Standards on Auditing (ISAs) issued by the International Auditing and Assurance Board (IAASB) was adopted by the HKICPA Council in 2001.
- All HKSA converged with ISAs with effective from 2005.



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1. Background (Cont'd)

- In March 2009, IAASB completed its comprehensive review on all of its ISAs and International Standards on Quality Control (ISQCs) (i.e. Clarity Project)
 - The improvements go beyond the enhancement of the understandability of the ISAs through the application of the new clarity conventions, they also include changes to requirements under certain auditing standards.



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1. Background (Cont'd)

- The final set of clarified standards comprises 36 ISAs and International Standard on Quality Control (ISQC) 1 including:
 - one new standard, addressing communication of deficiencies in internal control;
 - 16 standards containing new and revised requirements (referred to as “revised and redrafted ISAs”); and
 - 20 standards that have been redrafted to apply the new conventions and reflect matters of general clarity only (referred to as “redrafted ISAs and redrafted ISQC 1”).



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1. Background (Cont'd)

- All clarified ISAs contain certain improvements arising from the Clarity Project, including:
 - Identify the auditor's overall objectives when conducting an audit in accordance with the Clarified ISAs, setting an objective in each clarified ISA and establishing the auditor's obligation in relation to those objectives; and
 - Clarify the obligations imposed on professional accountants by the requirements of the standards. Requirements will be identified by the word "shall" instead of "should"
 - It more clearly expresses an obligation and therefore would be more in line with the high degree of obligation inherent in a requirement in the standards
 - It would align terminology with that used in IFRS.



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1. Background (Cont'd)

- Eliminating any possible ambiguity about the requirements a professional accountant needs to fulfill arising from the use of the present tense in current standards:
 - Present tense will no longer be used to describe actions or procedures; and
 - Sentences describing actions or procedures in the present tense are redrafted either by elevating the action or procedure to the status of a requirement or by using words that make it clear that there is no intention to create a requirement.



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1. Background (Cont'd)

- Improving the overall readability and understandability of the standards through structural and drafting improvements, including making the application material contained in the standards clearer:
 - 4 principal sections (introduction, objective, requirements, application material);
 - Reducing or eliminating duplication within individual standards – improving overall clarity through more effective presentation;
 - Making use of shorter sentences and other formatting techniques such as bullet points, headings and sub-heading – improving understandability and flow;
 - Highlighting considerations specific to small entities and public sector entities through the use of specific sub-headings within the application material.



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1. Background (Cont'd)

- The Institute's auditing and assurance standards committee is currently updating the HKSAs. The clarified HKSAs will use the equivalent ISAs as the underlying standard and will conform with the equivalent ISAs.
- The Institute has issued the clarified HKSAs in batches with the first batch, second batch and third batch issued in June, July and September 2009 respectively.



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1. Background (Cont'd)

- The clarified HKSAAs are to be effective for the audits of financial statements for periods beginning on or after 15 December 2009.
 - For those companies that have 31-December year end, the first audit using the clarified standards would normally be for the period ending 31 December 2010.
- The clarified HKSQC 1 is to be effective as of 15 December 2009.
 - All firms of professional accountants in respect of audits and reviews of financial statements, and other assurance and related services engagements are required to establish systems of quality control in compliance with clarified HKSQC 1 by 15 December 2009.
 - However, given that this is only a redrafted (not revised) HKSQC, there are no changes to the existing requirements.



1. Background (Cont'd)

- It would be a good idea for auditors to get a clear understanding of the clarified standards as soon as practicable to make the necessary changes to audit procedures and documentation, and to train audit partners and staff before applying the new standards.
- Research in other jurisdictions suggests that costs for implementing a new set of auditing standards are not likely to skyrocket as some reports have speculated.
 - While there will be some costs in changing procedures and documentation, in training staff and partners, and in potential additional audit time to accommodate first-time implementation, recurrent cost increases will not be significant.



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1. Background (Cont'd)

- The Institute's practice review inspections will, in time, review audit engagements completed under the clarified standards.
- The quality assurance department will approach reviews reasonably, understanding that practices may need advice during first-time application.
 - However, the department will expect members to show effort in making changes to audit methodology and documentation, and to properly implement and apply the revised standards within a reasonable time.



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Part 2

KEY CHANGES OF REVISED AND REDRAFTED HKSA_s

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2. Main changes

- The final set of clarified standards comprises 36 ISAs and International Standard on Quality Control (ISQC) 1 including:
 - one new standard, addressing communication of deficiencies in internal control;
 - 16 standards containing new and revised requirements (referred to as “revised and redrafted ISAs”); and
 - 20 standards that have been redrafted to apply the new conventions and reflect matters of general clarity only (referred to as “redrafted ISAs and redrafted ISQC 1”).



2. Main Changes (Cont'd)

- The 17 standards containing new and revised requirements (revised and redrafted ISAs) includes:
 1. ISA 200 - Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing
 2. ISA 260 - Communication with Those Charged with Governance
 3. ISA 265 - Communicating Deficiencies in Internal Control to Those Charged with Governance and Management
 4. ISA 320 - Materiality in Planning and Performing an Audit
 5. ISA 402 - Audit Considerations Relating to an Entity Using a Service Organization
 6. ISA 450 - Evaluation of Misstatements Identified during the Audit
 7. ISA 505 - External Confirmations
 8. ISA 540 - Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures



2. Main Changes (Cont'd)

9. ISA 550 - Related Parties
10. ISA 580 - Written Representations
11. ISA 600 - Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)
12. ISA 620 - Using the Work of an Auditor's Expert
13. ISA 705 - Modifications to the Opinion in the Independent Auditor's Report
14. ISA 706 - Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report
15. ISA 800 - Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks
16. ISA 805 - Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement
17. ISA 810 - Engagements to Report on Summary Financial Statements



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- The followings are selected key changes of the revised and redrafted HKSAs and are not intended to be a complete summary.
- A number of forums and seminars are to be organized to let members discuss the implications of the clarified standards and practical strategies to help them cope with the changes.
- Attached as Annex 1 is a copy of the HKSA 265 (Clarified) for reference.



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1. **HKSA 200 (Clarified)**

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

Why revisions are made to HKSA 200 (Clarified)?

- HKSA 200 (Clarified) deals with the independent auditor's overall responsibilities when conducting an audit of financial statements in accordance with HKSAs.
- This fundamental HKSA contains an overview of an audit to aid in understanding its purpose and scope; defines the respective authority of the requirements and guidance in HKSAs; and contains the most fundamental requirements for auditors. It emphasizes the importance of sound and consistent professional judgment by the auditor, and the necessity for sufficient audit evidence to support the auditor's opinion.



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- **Highlights of the standard**
 - HKSA 200 (Clarified) sets out the conventions followed in the standards and the obligations of the auditors who follow them.
 - HKSA 200 (Clarified) contains fundamental requirements to auditors, examples include:
 - Ethical Requirements relating to an audit of financial statements;
 - Professional skepticism;
 - Professional judgment; and
 - Sufficient appropriate audit evidence and audit risk.



- **Distinguishment of applicable financial reporting framework**
 - HKSA 200 (Clarified) provides guidance for distinguishing “fair presentation framework” and “compliance framework” which affects the required opinion to be rendered.
 - **Fair presentation framework** is a financial reporting framework that requires compliance with the requirements of the framework and:
 - a) Acknowledge 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;
 - b) Acknowledge 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. *(Para.13(a) of HKSA 200 (Clarified))*



- **Audit opinion consideration for fair presentation framework** - For a fair presentation framework, as is generally the case for general purpose financial statements, the opinion required by the HKSAs is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view. *(Para.A13 of HKSA 200 (Clarified))*
- **Compliance framework** is a financial reporting framework that requires compliance with the requirements of the framework but does not contain the acknowledgements in (a) and (b) of “fair presentation framework”. *(Para.13(a) of HKSA 200 (Clarified))*
- **Audit opinion consideration for compliance framework** - For a compliance framework, the opinion required is on whether the financial statements are prepared, in all material respects, in accordance with the framework. *(Para.A13 of HKSA 200 (Clarified))*



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2. HKSA 260 (Clarified) ***Communication with Those Charged with Governance***

Why revisions are made to HKSA 260 (Clarified)?

- HKSA 260 (Clarified) deals with the auditor's responsibility to communicate with those charged with governance in an audit of financial statements.
- The standard is revised to enhance the two-way communication in an audit of financial statements by providing an overarching framework for the auditor's communication with those charged with governance, and identifies some specific matters to be communicated with them.



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- **Expanded guidelines to matters to be communicated**
 - The auditor's responsibilities in relation to the financial statement audit; *(Para.14 of HKSA 260 (Clarified))*
 - Planned scope and timing of the audit;
 - Significant findings from the audit
 - Auditor's view about significant qualitative aspects of the entity's accounting practice, including accounting policies, accounting estimates and financial statements disclosure; *(Para.16(a) of HKSA 260 (Clarified))*
 - Significant difficulties encountered during the audit; *(Para.16(b) of HKSA 260 (Clarified))*



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- Unless all those charged with governance are involved in managing the entity: *(Para.16(c) of HKSA 260 (Clarified))*
 - Significant matters, if any, arising from the audit that were discussed, or subject to correspondence with management; and
 - Written representations the auditor is requesting;
- Other matters arising from the audit that are significant to the oversight of the financial reporting process; *(Para.16(d) of HKSA 260 (Clarified))*
- Auditor independence (for listed entities) *(Para.17 of HKSA 260 (Clarified))*
 - The related safeguards that have been applied to eliminate identified threats to independence or reduce them to an acceptable level.



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- **Forms of communication**

(Para. 19 of HKSA 260 (Clarified))

- The auditor shall communicate in **writing** with those charged with governance regarding significant findings from the audit if, **in the auditor's professional judgment, oral communication would not be adequate.**
 - Written communication need not include all matters that arose during the course of the audit.

- **See Annex 2 for the specific requirements in HKSQC 1 and other HKSA's that refer to communication with those charged with governance.**



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3. HKSA 265 (Clarified) - New *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*

Why having a new auditing standard HKSA 265 (Clarified)?

- HKSA 265 is a new auditing standard deals with the auditor's responsibility to communicate appropriately to those charged with governance and management deficiencies in internal control that the auditor has identified in an audit of financial statements.
- IAASB commenced this project in response to regulatory and standard-setting developments around the world regarding internal control-related matters. HKSA 265 (Clarified) does not impose additional responsibilities on the auditor regarding obtaining an understanding of internal control and designing and performing tests of controls over and above the requirements of HKSA 315 (Clarified) and HKSA 330 (Clarified).



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- **Communication with those charged with governance and management at an appropriate level of responsibility**
 - **Significant deficiencies in internal control**
 - Communicate in writing to those charged with governance on a timely basis; *(Para.9 of HKSA 265)*
 - Communicate in writing the significant deficiencies that the auditor has communicated or intends to communicate to those charged with governance, unless it would be inappropriate to communicate directly to management at an appropriate level of responsibility in the circumstances.
(Para.10(a) of HKSA 265)



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- **Deficiencies in internal control (other than significant deficiencies)**
 - Other deficiencies in internal control identified during the audit that have not been communicated to management at an appropriate level of responsibility by other parties and that, in the auditor's professional judgment, are of sufficient importance to merit management's attention; *(Para.10(b) of HKSA 265)*
 - The communication need not be in writing but may be oral. If communicated orally, a formal communication need not be made subsequently. *(Para.A23 of HKSA 265)*



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- **Matters to be included in written communication of significant deficiencies in internal control**

(Para.11 of HKSA 265)

- A description of the deficiencies and an explanation of their potential effects;
- The purpose of the audit was for the auditor to express an opinion on the financial statements;
- The audit included consideration of internal control relevant to the 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 internal control; and
- The matters being reported are limited to those deficiencies that the auditor has identified during the audit and that the auditor has concluded are of sufficient importance to merit being reported to those charged with governance.



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4. HKSA 320 (Clarified)

Materiality in Planning and Performing an Audit

Why revisions are made to HKSA 320 (Clarified)?

- HKSA 320 (Clarified) deals with the auditor's responsibility to apply the concept of materiality in planning and performing an audit of financial statements.
- IAASB commenced the project due to the need for greater consideration of the nature of an item and of the circumstances of the entity when determining materiality and evaluating misstatements. As a result, revisions are made to the standard.
- The requirements in relation to evaluation of misstatements identified during the audit, which was previously covered by HKSA 320 before Clarity Project, are now separately covered in HKSA 450 (Clarified).



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■ Performance materiality

- The auditor is required to determine the following:
 - (1) Materiality level for the financial statement as a whole.
(Para.10 of HKSA 320 (Clarified))
 - (2) Materiality level(s) for one or more particular classes of transactions, account balances or disclosures (if required by considering the specific circumstances of the entity). *(Para.10 of HKSA 320 (Clarified))*
 - (3) **Performance materiality** for purposes of assessing the risks of material misstatement and determining the nature, timing and extent of further audit procedures. *(Para. 11 of HKSA 320 (Clarified))*



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▪ What is performance materiality?

(Para.9 of HKSA 320 (Clarified))

- Performance materiality is defined as the amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriate 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.

Performance materiality may be more than one amount!



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- **What is the reason for establishing performance materiality?** *(Para.A12 of HKSA 320 (Clarified))*
 - Planning the audit solely to detect individual material misstatements overlooks the fact that the aggregate of individually immaterial misstatements may cause the financial statements to be materially misstated, and leave no margin for possible undetected misstatements.
 - Performance materiality is set for the financial statements as a whole and, if applicable, for particular class of transaction, account balance or disclosure.



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↑
Materiality

1. Materiality level for the financial statement as a whole

2. Materiality level(s) for particular class(es) of transactions, account balances or disclosures (if required)

3. Performance materiality

- For the financial statements as a whole
- For particular class(es) of transaction, account balances or disclosure (if required)



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- **Extract from HKICPA Audit Practice Manual**

“All errors should be recorded, so that their cumulative impact on the accounts may be assessed, and so that their disposal may be documented.”



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5. **HKSA 402 (Clarified)** *Audit Considerations Relating to an Entity Using a Service Organization*

Why revisions are made to HKSA 402 (Clarified)?

- HKSA 402 (Clarified) deals with the user auditor's responsibility to obtain sufficient appropriate audit evidence when a user entity uses the services of one or more service organizations.
- IAASB commenced the project on the subject since the use of service organizations has advanced and the relationship between service organizations and entities has become more complex. Consequently, the standard is revised with additional guidance incorporated.



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- **Expanded guidance on obtaining an understanding of the services provided by a service organizations**
 - The user auditor shall obtain an understanding of how a user entity uses the services of a service organization in the user entity's operations. *(Para.9 of HKSA 402 (Clarified))*
 - The user auditor shall evaluate the design and implementation of relevant controls at the user entity that relate to the services provided by the service organization, including those are applied to the transactions processed by the service organization. *(Para.10 of HKSA 402 (Clarified))*



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- If user auditor is not able to obtain a sufficient understanding from the user entity, the user auditor will obtain the understanding from one of the following procedures:
 - Obtaining a type 1 or type 2 report, if available;
 - Contacting the service organization, through the user entity, to obtain specific information;
 - Visiting the service organization and perform necessary procedures; and
 - Use another auditor to perform necessary procedures.

- In determining the sufficiency and appropriateness of the audit evidence provided by type 1 or type 2 report, the user auditor considers:
 - Service auditor's professional competence and independence; and
 - Adequacy of standards under which the type 1 or type 2 report was issued. (i.e. service auditor may be practicing in a jurisdiction where different standards are followed).



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- **Responding to the assessed risks of material misstatement**
 - The user auditor shall:
 - Determine whether relevant sufficient appropriate audit evidence is available from records held at the user entity, if not, the user auditor will perform further audit procedures or use another auditor to perform those procedures at the service organization on the user auditor's behalf. *(Para.15 of HKSA 402 (Clarified))*
 - When the user auditor's risk assessment includes an expectation that controls at the service organization are operating effectively, the user auditor will perform one or more of the following procedures: *(Para.16 of HKSA 402 (Clarified))*
 - Obtaining a type 2 report if available;
 - Performing appropriate tests of controls at the service organization; or
 - Use another auditor to perform tests of controls at the service organization on behalf of the user auditor.



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6. **HKSA 450 (Clarified)** *Evaluation of Misstatements Identified during the Audit*

Why revisions are made to HKSA 450 (Clarified)?

- HKSA 450 (Clarified) deals with the auditor's responsibility to evaluate the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements.
- IAASB commenced the project due to the need for greater consideration of the nature of an item and of the circumstances of the entity when determining materiality and evaluating misstatements.
- The subject was previously covered in HKSA 320 before Clarity Project.



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- **Accumulation of identified misstatements**
 - The auditor shall accumulate misstatements identified during the audit, other than those that are clearly trivial.
(Para.5 of HKSA 450 (Clarified))

- **Prior period uncorrected misstatements consideration**
 - When determining whether uncorrected misstatements are material, individually or in aggregate, the auditor shall also consider the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account or disclosures, and the financial statements as a whole. *(Para.11(b) of HKSA 450 (Clarified))*



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7. ISA 505 (Clarified) *External Confirmations*

Why revisions are made to ISA 505 (Clarified)?

- ISA 505 (Clarified) deals with the auditor's use of external confirmation procedures to obtain audit evidence in accordance with the requirements of HKSA 330 (Clarified) "*The Auditor's Responses to Assessed Risks*" and HKSA 500 (Clarified) "*Audit Evidence*".
- IAASB commenced the project on the subject as a number of high profile corporate financial failures in the recent past have elevated awareness of the use of, and consideration of the reliability of, external confirmations as audit evidence.



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▪ **Expanded guidance on external confirmation procedures**

(Para.7 of ISA 505 (Clarified))

- Expanded guidance on:
 - Determining the information to be confirmed or requested;
 - Selecting the appropriate confirming party;
 - Designing the confirmation requests, including determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor; and
 - Sending the requests, including follow-up requests when applicable, to the confirming party.



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- The auditor is required by HKSA 500 (Clarified) “Audit Evidence” to determine whether to modify or add procedures to resolve doubts over the reliability of information to be used as audit evidence. The auditor may choose to verify the source and contents of a response to a confirmation request by contacting the confirming party.
(Para.A14 of ISA 505 (Clarified))
- Oral response to a confirmation request does not meet the definition of an external confirmation because it is not a direct written response to the auditor. *(Para.A15 of ISA 505 (Clarified))*



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8. HKSA 540 (Clarified) *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*

Why revisions are made to HKSA 540 (Clarified)?

- HKSA 540 (Clarified) deals with the auditor's responsibilities relating to accounting estimates, including fair value accounting estimates, and related disclosures in an audit of financial statements.
- IAASB commenced the project on the subject since more guidance are required for auditors with the wider use of fair value accounting.
- The topic was previously covered in HKSA 540 and HKSA 545 where HKSA 540 (Clarified) combined the subjects and will accordingly withdraw HKSA 545.



- **Expanded guidance on risk assessment procedures and related activities** – *(Para.8-9 of HKSA 540 (Clarified))*
 - Auditor shall obtain an understanding of the following:
 - Requirements of applicable financial reporting framework;
 - How management identifies those transactions, events and conditions that may give rise to the need for accounting estimates;
 - How management makes the accounting estimates and an understanding of the data on which they are based;
 - Outcome of accounting estimates included in the prior period financial statements, or, where applicable, their subsequent re-estimation for the purpose of the current period.
 - The review is not intended to call into question the judgments made in the prior periods that were based on information available at the time.



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- **Expanded guidance on identifying and assessing the risks of material misstatement**

(Para.10-11 of HKSA 540 (Clarified))

- The auditor shall evaluate the degree of estimation uncertainty associated with an accounting estimates.
- The auditor shall determine whether any of those accounting estimates that have been identified as having high estimation uncertainty give rise to significant risks.



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- **Responses to the assessed risk of material misstatement**
 - The auditor shall undertake one or more of the following, taking account of the nature of the accounting estimate: *(Para.13 of HKSA 540 (Clarified))*
 - Determine whether events occurring up to the date of the auditor’s report provide audit evidence regarding the accounting estimate.
 - Test how management made the accounting estimate and the data on which it is based:
 - Is the method of measurement appropriate and are the assumptions used reasonable?
 - Test the operating effectiveness of the controls over how management made the accounting estimate, together with appropriate substantive procedures.
 - Develop a point estimate or a range to evaluate management’s point estimate.



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- The auditor shall consider whether specialized skills or knowledge are required in order to obtain sufficient appropriate audit evidence. *(Para.14 of HKSA 540 (Clarified))*
 - Consider the need of engaging an auditor’s expert

- **Indicators of possible management bias** *(Para.21 of HKSA 540 (Clarified))*
 - Auditor shall review the judgments and decisions made by management in the making of accounting estimates for identification of indicators of possible management bias.
 - Indicators do not themselves constitute misstatements.



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9. HKSA 550 (Clarified) ***Related Parties***

Why revisions are made to HKSA 550 (Clarified)?

- HKSA 550 (Clarified) deals with the auditor's responsibilities relating to related party relationships and transactions in an audit of financial statements.
- IAASB commenced the project on the subject in response to a number of developments:
 - The major corporate scandals of earlier part of this decade have highlighted that fraudulent financial often arises through the involvement of related parties.
 - There is a need to focus more on the identification and assessment of risks of material misstatement associated with related party relationship and transactions, and on the responses to such risks.



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- **Expanded guidance on identification of significant transactions outside the entity's normal course of business**

(Para.15 and 16 of HKSA 550 (Clarified))

- If the auditor identifies significant transactions outside the entity's normal course of business when inspecting records or documents or through other audit procedures, the auditor shall inquire of management about:
 - The nature of the transactions;
 - Whether related parties could be involved.



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- **Expanded guidance on responses to the identification of previously unidentified or undisclosed related parties or significant related party transactions**
(Para.20-22 of HKSA 550 (Clarified))
 - Auditor shall determine whether the underlying circumstances confirm the existence of those relationships or transactions.
 - If such transaction is identified, the auditor shall:
 - Promptly communicate the relevant information to the other engagement team members;
 - Request management to identify all transactions with the newly identified related parties for the auditor’s further evaluation;



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- Inquiry as to why the entity's controls over related party relationships and transactions failed to enable the identification or disclosure of the related party relationship or transactions;
- Perform appropriate substantive audit procedures relating to such newly identified related parties or significant related party transactions;
- Reconsider the risk that other related parties or significant related party transactions may exist that management has not previously identified or disclosed to the auditor, and perform additional audit procedures as necessary; and
- If non-disclosure by management appears intentional, evaluate the implications for the audit.



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10. HKSA 580 (Clarified) ***Written Representation***

Why revisions are made to HKSA 580 (Clarified)?

- HKSA 580 (Clarified) deals with the auditor's responsibility to obtain written representations from management and, where appropriate, those charged with governance in an audit of financial statements.
- IAASB commenced the project on the subject to address concerns that the auditor may be over-relying on written representations.



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- **Written representations as audit evidence**
 - Although written presentations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal.
 - The fact that management has provided reliable written representations does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfillment of management’s responsibilities, or about specific assertion. *(Para. 4 of HKSA 580 (Clarified))*



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- **Doubts as to the reliability of written representations**
 - If the auditor has concerns about the competence, integrity, ethical values or diligence of management, or about its commitment to or enforcement of these, the auditor shall determine the effect that such concerns may have on the reliability of representations (oral or written) and audit evidence in general. *(Para. 16 of HKSA 580 (Clarified))*
 - If written representations are inconsistent with other audit evidence, the auditor shall perform audit procedures to attempt to resolve the matter. *(Para. 17 of HKSA 580 (Clarified))*



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- If the auditor concludes that the written representations are not reliable, the auditor shall take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with HKSA 705 "Modifications to the Opinion in the Independent Auditor's Report". *(Para.18 of HKSA 580 (Clarified))*
- The auditor shall disclaim an opinion on the financial statements if he concludes that there is sufficient doubt about the integrity of management such that the required written representations on preparation of the financial statements and information provided and completeness of transactions are not reliable. *(Para.20 of HKSA 580 (Clarified))*



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- **See Annex 3 for the list of HKSAs containing requirements for written representations and an illustrative representation letter.**



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11. ISA 600 (Clarified)

Special Consideration – Audits of Group Financial Statements (Including the Work of Component Auditors)

Why revisions are made to ISA 600 (Clarified)?

- ISA 600 (Clarified) apply to group audits and deals with special considerations that apply to group audits, in particular those that involve component auditor.
- IAASB commenced the project on the subject in responded to the requests by various national standard setters while there is no substantive guidelines addressing group audit.
- The subject is currently covered under Statement of Auditing Standards 510 “Principal Auditors and Other Auditors” before the Clarity Project. With the launching of ISA 600 (Clarified), the guidelines and requirements are expanded.



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■ **Responsibility**

(Para.11 of ISA 600 (Clarified))

- 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 requirement, and whether the auditor's report that is issued is appropriate in the circumstances.
 - 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.



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- **Expanded guidance on understanding the component auditor**
(Para.19 of ISA 600 (Clarified))
 - 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:
 - (a) Understanding and compliance of ethical requirements by component auditor;
 - (b) The component auditor's professional competence;
 - (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; and
 - (d) Whether the component auditor operates in a regulatory environment that actively oversees auditors.



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- **Determining the type of work to be performed on the financial information of components**
 - ISA 600 (Clarified) contains guidelines on the subject based on the significance of the components:
 - Significant due to its individual financial significance to the group; *(Para.26 of ISA 600 (Clarified))*
 - Significant due to its specific nature or circumstances; and *(Para.27 of ISA 600 (Clarified))*
 - Not significant *(Para.28-29 of ISA 600 (Clarified))*

Please see Annex 4 for the extract of the guidance.



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- **Expanded guidance on communication with the component auditor**
 - The communication from group engagement team to component auditor 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 auditor. *(Para.40 of ISA 600 (Clarified))*
 - **Please see Annex 5 for the examples of matters about which the group engagement team obtains an understanding, list of matters for inclusion in the group engagement team's letter of instruction and the sample confirmation to be obtained from the component auditor prior work on the financial information of the component commence.**



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12. HKSA 620 (Clarified) *Using the Work of an Auditor's Expert*

Why revisions are made to HKSA 620 (Clarified)?

- HKSA 620 (Clarified) deals with the auditor's responsibilities relating to the work of an individual or organization in a field of expertise other than accounting or auditing, when that work is used to assist the auditor in obtaining sufficient appropriate audit evidence.
- IAASB commenced the project on the subject since it is anticipated that the auditor may require more frequent use of experts with the wider use of fair value accounting.



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- The current extant HKSA 620 deals with both auditor's expert and management's expert. HKSA 620 (Clarified) deals exclusively with considerations relevant to using the work of an auditor's expert and the materials dealing with the work of a management's expert was presented in the redrafted HKSA 500 (Clarified).



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▪ **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 partner or staff, including temporary staff, of the auditor's firm or a network firm), or an auditor's external expert.
(Para.6(a) if HKSA 620 (Clarified))



- **Expanded guidance on evaluation of competence, capabilities and objectivity of the auditor's expert**
 - The auditor shall evaluate whether the auditor's expert has the necessary competence, capabilities (i.e. the ability of the auditor's expert to exercise that competence in the circumstances of the engagement) and objectivity for the auditor's purpose.
 - An auditor's expert can be either an individual or an organization. The auditor may have previous experience to the organization but not for the personnel assigned to the engagement; or it may be the reverse.
 - Both the personal attributes of the individual and the managerial attributes of the organization (such as systems of quality control the organization implements) may be relevant to the auditor's evaluation. *(Para.A3 of HKSA 620 (Clarified))*
 - In some case, it may be appropriate for the auditor to obtain a written representation from the auditor's external expert about any interests or relationships with the entity of which that expert is aware. *(Para.A20 of HKSA 620 (Clarified))*.



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- **Expanded guidance on agreement with the auditor's expert**
 - Please see Annex 6 for the list of considerations for agreement between the auditor and an auditor's external expert.

- **Expanded guidance on the auditor's responsibility for the audit opinion**
 - The auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the auditor's use of the work of an auditor's expert. *(Para.3 of HKSA 620 (Clarified))*

 - The auditor shall not refer to the work of an auditor's expert in an auditor's report containing an unmodified opinion unless required by law or regulation to do so. *(Para.14 of HKSA 620 (Clarified))*



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- **Expanded guidance on evaluating the adequacy of the auditor's expert work**
 - The auditor shall evaluate the adequacy of the auditor's expert work for the auditor's purpose including: *(Para.12 of HKSA 620 (Clarified))*
 - Relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence;
 - If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods in the circumstances; and
 - If that expert's work involves the use of source data that is significant to that expert's work, the relevance, completeness and accuracy of that source data.



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- If that expert's work involves the use of source data that is significant to that expert's work, the relevance, completeness and accuracy of that source data.
 - Procedures such as the following maybe used to test that data: *(Para.A38 of HKSA 620 (Clarified))*
 - (i) verifying the origin of the data, including obtaining an understanding of, and where applicable testing, the internal controls over the data and, where relevant, its transmission to the expert.
 - (ii) reviewing the data for completeness and internal consistency.
- If the auditor determines that the work of the auditor's expert is not adequate for the auditor's purpose, the auditor shall: *(Para.13 of HKSA 620 (Clarified))*
 - Agree with that expert on the nature and extent of further work to be performed by that expert; or
 - Perform additional audit procedures appropriate to the circumstances.



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13. ISA 705 (Clarified) *Modifications to the Opinion in the Independent Auditor's Report*

Why revisions are made to ISA 705 (Clarified)?

- ISA 705 (Clarified) deals with the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with HKSA 700 (Clarified), the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary.
- Certain standards and guidance on modifications to the auditor's opinion and "Emphasis of Matter" paragraph are enhanced to increase consistency in reporting among jurisdictions.



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- The modification to the opinion in the independent auditor's report was previously under HKSA 701 before the Clarity Project.



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- **Clarified guidance in determining the type of modification to the Auditor's Opinion**

<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



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- **Prohibition on Issuing a Piecemeal Opinion**
 - When the auditor considers it necessary to express an adverse opinion or disclaim an opinion on the financial statements as a whole, the auditor shall not also include an unmodified opinion with respect to the same financial reporting framework on a single financial statements or one or more specific elements, accounts or items of a financial statements. *(Para.15 of ISA 705 (Clarified))*



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- **New mandated auditor's actions in the case of a management-imposed scope limitation after the auditor has accepted the engagement**
 - Request management to remove the limitation. *(Para.11 of ISA 705 (Clarified))*
 - If management refuses to remove the limitation, communicate the matter to those charged with governance and determine whether it is possible to perform alternative procedures. *(Para.12 of ISA 705 (Clarified))*



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- If the auditor is unable to obtain sufficient appropriate audit evidence: *(Para.13 of ISA 705 (Clarified))*
 - If the possible effects on the financial statements of undetected misstatements:
 - Material but not pervasive:
the auditor shall qualify the opinion.
 - Both material and pervasive:
 - withdraw if practicable and possible under applicable laws and regulations or
 - if withdrawal is not practicable or possible, disclaim an opinion on the financial statements.

Sample modified reports with local guidance will be included in HKSA 705 (Clarified) when it is issued.



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14. ISA 706 (Clarified)

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

Why revisions are made to ISA 706 (Clarified)?

- **ISA 706 (Clarified) deals with additional communication in the auditor's report when the auditor considers it necessary to:**
 - Draw users' attention to (i) a matter or matters presented or disclosed and (ii) any matter or matters other than those presented or disclosed in the financial statements that are of such importance that they are fundamental to users' understanding of the financial statements.
 - "Emphasis of matter" was previously dealt with by HKAS 701 before the Clarity Project. The standard is enhanced to increase consistency in reporting among jurisdictions.



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- The issues related to “Emphasis of Matter” paragraph was previously under HKSA 701 before the Clarity Project.



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- **The “Emphasis of Matter” paragraph is included in the auditor’s report when – *(Para.6 of ISA 706 (Clarified))***
 - The auditor considers it necessary to draw users’ attention to a matter presented or disclosed in the financial statements, in the auditor’s judgment, is of such importance that it is fundamental to users’ understanding of the financial statements; and
 - The auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements.



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- **Expanded guidelines in “Emphasis of Matter” paragraph and the use of mandatory sub-headings: - (Para.7 of ISA 706(Clarified))**
 - Include the paragraph immediately after the Opinion paragraph in the auditor’s report;
 - Use the heading “Emphasis of Matter” or other appropriate heading;
 - 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
 - Indicate that the auditor’s opinion is not modified in respect of the matter emphasized.



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- **“Other Matter” paragraph:** - *(Para. 8 of ISA 706 (Clarified))*
 - “Other Matter” paragraph shall be used when the auditor considers it is 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 responsibility or the auditor’s report.
 - Include the 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.
 - Use the heading “Other Matter” or other appropriate heading.



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See Annex 7 for the list of ISAs containing requirements for “Emphasis of Matter” and “Other Matter” paragraphs and the illustration of an auditor’s report that includes an “emphasis of matter” paragraph.



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15. ISA 800 (Clarified)

Special Considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks

16. ISA 805 (Clarified)

Special Considerations – Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement

17. ISA 810 (Clarified)

Engagements to report on Summary Financial Statements



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ISA 800, 805 and 810 (Clarified)

Why revisions are made to the standards?

- The ISAs (and hence HKSAs) in the 100-700 series apply to an audit of financial statements and are to be adapted as necessary in the circumstances when applied to audits of other historical financial information.
- ISA 800 (Clarified) deals with special considerations in the application of those ISAs to an audit of financial statements prepared in accordance with a special purpose framework.



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ISA 800, 805 and 810 (Clarified)

- ISA 805 (Clarified) deals with special considerations in the application of those ISAs to an audit of a single financial statement or of a specific element, account or item of a financial statement.
- ISA 810 (Clarified) deals with the auditor's responsibilities relating to an engagement to report on summary financial statements derived from financial statements audited in accordance with ISAs by that same auditor.
- There is currently no HKSAs covering the extant of ISA 800 (Clarified) and 805 (Clarified) and the extant of ISA 810 (Clarified) is currently covered by PN 710 "The auditors' statement on the summary financial report".



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ISA 800, 805 and 810 (Clarified)

- **The Institute is currently researching the implication of local adoption of ISA 800 and ISA 805 and liaising with stakeholders (including governmental agencies) on the potential adoption of the standards.**



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Part 3

SUPPORT EVENTS AND FACILITIES

Presented by

**Chris Joy
Executive Director
Hong Kong Institute of CPAs**



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Support Events and Facilities

- The Institute recognizes that the introduction and first time application of the clarified HKSAs may have some cost implications for auditors but believes that this can be minimized through appropriate training and support.
- IFAC has developed an online IAASB clarity centre at <http://web.ifac.org/clarity-center/index> to help with the implementation of the clarified ISAs.
- IAASB is currently developing a series of ISA modules on a number of clarified ISAs which will be available on the clarity centre website free of charge.



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Support Events and Facilities (Cont'd)

- The Institute will be holding a number of forums to address practical implementation issues. The Institute will also draw on IFAC initiatives to assist practitioners in implementation.
- The Institute's publications "Guide to Quality Control" and "Audit Practice Manual" will be updated as necessary to reflect the changes in procedures that will be required as a result of implementing the clarified HKSAs.



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Thank you for your attention

Questions and Answers

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