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About the Lecturer



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*FCA(UK), FCCA, FAIA,
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- ❖ Practising partner of a medium size firm
- ❖ Practical experience in corporate governance, risk management, auditing and tax
- ❖ Professional training over 10 years ago and has been teaching MC & MD since then
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Module C – Business Assurance



Module Preparation Seminar – Agenda

- **Audit reporting (Ch.17)**
 - **HKSA 701 communicating key audit matters in the independent auditor's report**
 - **HKSA 720 (Revised) The auditor's responsibilities relating to other information**
- **Corporate Governance Repots and Practice (Ch. 2)**

Audit reporting: HKSA 701 communicating key audit matters in the independent auditor's report





HKSA 700 (Revised)

Forming an Opinion and Reporting on Financial Statements

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Basic elements of the auditor's report



Unmodified Opinion

An unmodified opinion is 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.

Basic elements of audit report	Explanation
Title	The auditor's report must have a title that clearly indicates that it is the report of the independent auditor . This signifies that the auditor has met all the ethical requirements concerning independence and therefore distinguishes the auditor's report from other reports.
Addressee	The addressee will be determined by law or regulation, but is likely to be the shareholders or those charged with governance. [ie Board of directors]

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Basic elements of the auditor's report



Basic elements of audit report	Explanation
Opinion paragraph	<p>Now presented first!</p> <ul style="list-style-type: none"> • must identify the entity being audited, state that the financial statements have been audited, identify the title of each statement that comprises the financial statements being audited, refer to the summary of significant accounting policies and other explanatory notes, and specify the date or period covered • expresses an unmodified opinion on financial statements, shall use one of the following equivalent phrases:
Same Meaning	<p>The financial statements present fairly, in all material respects, ... in accordance with [the applicable financial reporting framework]; or The financial statements give a true and fair view of ... in accordance with [the applicable financial reporting framework].</p>

Basic elements of the auditor's report



Basic elements of audit report	Explanation
Basis for opinion	<ul style="list-style-type: none"> • The basis for opinion paragraph must state that the audit was conducted in accordance with the HKSA's, and refer to the 'Auditor's responsibilities for the audit of the financial statements' section which describes the auditor's responsibilities under the HKSA's.
Affirmative statement	<ul style="list-style-type: none"> • The auditor must also state that they are independent of the audited entity, in accordance with the relevant ethical requirements relating to the audit.
Same as previous	<ul style="list-style-type: none"> • Finally, the auditor must state that they believe the audit evidence obtained is sufficient and appropriate to provide a basis for the audit opinion.

Basic elements of the auditor's report



Basic elements of audit report	Explanation
Going concern	<ul style="list-style-type: none"> Where the auditor considers a material uncertainty related to going concern exists, this should be described in a separate paragraph headed 'Material uncertainty related to going concern'. [Refer to HKSA 570 (Revised)]
Key audit matters	<ul style="list-style-type: none"> For the audit of listed entities, or where required by law or regulation, the auditor should Include a 'Key audit matters' section.
Mandatory → Listed companies	<ul style="list-style-type: none"> This section describes the matters that, in the auditor's professional judgement, are most significant to the audit.
Voluntary unlisted companies	Refer to the back.

Basic elements of the auditor's report



Basic elements of audit report	Explanation
Other Information (HKSA 720(Revised))	<p>For the audit of listed entities or any other entity where the auditor has obtained other information, an 'Other information' section should be included in the auditor's report. This section should include:</p> <ul style="list-style-type: none"> a statement that management is responsible for the other information an identification of the other information obtained before the date of the auditor's report (for listed entities, also the other information expected to be obtained after the date of the auditor's report) [NEW] a statement that the auditor's opinion does not cover the other information a description of the auditor's responsibilities for reading, considering and reporting on other information, and where other information has been obtained, either a statement that the auditor has nothing to report, or a description of any uncorrected material misstatement
Refer to the back	

Basic elements of the auditor's report



Basic elements of audit report	Explanation
Responsibilities of Directors and Those Charged with Governance for the Financial Statements	This section should describe management's responsibility including the following: <ul style="list-style-type: none"> The preparation of the financial statements in accordance with the applicable financial reporting framework; ie HKFRS and HKCO
<div style="border: 1px solid black; padding: 2px; width: fit-content;"> HKSA 315 (Revised 2016) </div>	<ul style="list-style-type: none"> The implementation of such internal control as are necessary to enable the preparation of financial statements that are free from material misstatement, whether due to error or fraud.
<div style="border: 1px solid black; padding: 2px; width: fit-content;"> HKSA 570 </div>	<ul style="list-style-type: none"> The assessment of the entity's ability to continue as a going concern, the appropriateness of the going concern basis of accounting and adequacy of related disclosures;

Basic elements of the auditor's report



Basic elements of audit report	Explanation
Responsibilities of Directors and Those Charged with Governance for the Financial Statements	Reference shall be made to 'the preparation and fair presentation of these financial statements' (or 'the preparation of financial statements that give a true and fair view') where the financial statements are prepared in accordance with a fair presentation framework.
Auditor's responsibilities for the audit of the financial statements	The report must state that: <ul style="list-style-type: none"> the auditor's objectives - obtain reasonable assurance whether the financial statements as a whole are free from material misstatement, and to issue an auditor's report that includes the auditor's opinion; and

Basic elements of the auditor's report



Basic elements of audit report	Explanation
Auditor's responsibilities for the audit of the financial statements	<p>The report must state that:</p> <p>The report must also:</p> <ul style="list-style-type: none"> explain that misstatements can arise from fraud or error describe the meaning of materiality explain that the auditor exercises professional judgement and maintains professional scepticism throughout the audit describe the auditor's responsibilities in an audit.

Basic elements of the auditor's report



Basic elements of audit report	Explanation
Other reporting responsibilities	If the auditor is required by law to report on any other matters, this must be done in an additional paragraph titled 'Report on other legal and regulatory requirements' or otherwise as appropriate.
Name of the engagement partner	The name of the engagement partner should be identified.
Auditor's signature	The report must contain the auditor's signature , whether this is the auditor's own name or the audit firm's name or both.

Basic elements of the auditor's report



Basic elements of audit report	Explanation
Auditor's address	The location where the auditor practises must be included.
Date of the report	The report must 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.

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



How to determine KAM?



Objectives:

Determine key audit matters + Form an opinion on FS + Communicate those matters in the auditor's report

Determining KAM

- Select small number of most significant matters in the **current** audit requiring significant auditor's attention (not related to prior period's audits)
- Matters related to **higher** risks of material misstatements
- Matters that pose challenges to the auditors
- Matters relate to areas of **complexity and significant** management judgment in the FS ie involving expert
- Matters under HKSA 260 (Revised) – related party transactions / limitations on the group audit
- Difficult or contentious matters required for appropriate consultation

How to determine KAM? (Cont'd)



- Significant **qualitative** aspects – ie accounting estimates
- Significant events or Transactions that occurred during the period ie extensive discussion with management (ie **related party transactions** outside the normal course of business)

Purpose of the HKSA

- Enhance the **communicative value** of the auditor's report by providing **greater transparency** about the audit
- Additional information to **intended users** to understand the company and areas of significant management judgement - Users of FS may have expressed an interest in particular matters
- **Draw attention by the management and those charged with governance to the disclosure in the FS**

How to determine KAM? (Cont'd)



Be aware:

This HKSA is not substitute for:

- Disclosures in FS
- Modification of opinion under HKSA 705 (Revised)
(**Adverse Opinion** – still need to determine KAM)
(**Emphasis of Matter paragraphs and Other Matter paragraphs** cannot substitute KAM)
- Reporting the going concern issues under HKSA 570 (Revised)
- **Disclaimer of opinion** → No KAM Sector
- Disclosure of significant economic, accounting, regulatory, industry and developments affecting management's judgments and assumptions and affecting auditor's audit approach

How to determine "Significant" ?



What is significant?

By auditor's judgment – both quantitative and qualitative. Consider the following:

- Importance to intended users
- Complexity of the accounting policies
- The nature and extent of audit effort
- The extent of specialized skills or knowledge
- The nature of consultations outside the engagement team
- Any control deficiencies
- Size and complexity of the entity, nature of its business and environment

Examples: long-term contracts involving revenue recognition / litigation / accounting estimates

Communicating Key Audit Matters



Display in a **separate section** of the auditor's report

Heading "Key Audit Matters"

Only on KAM – most significance in the audit of FS of the current period (only) ; and matters in the context of the audit of FS as a whole

Order of presentation for KAM can be any, dependent on auditor's judgement.

Description of Individual KAM :

- How much to describe ?
- Depend on **intended users**
- Additional information explaining why the matter was considered to be significant
- New or enhanced disclosures such as **key assumptions** used in accounting estimates, quantitative and qualitative estimate uncertainty
- **Going concern indicators** ie substantial operating losses, no-compliance with loans and agreements

Communicating Key Audit Matters



Description of Individual KAM (cont'd) :

Principal considerations leading the auditor to determine it is a significant KAM:

- **Economic conditions affecting auditor's ability to collect audit evidence**
- **New or emerging accounting policies**
- **Changes in the entity's strategy or business model**

Communication with Those Charged with Governance

HKSA 260 (Revised) – Communicate with those charged with governance on a timely basis

- Communicate preliminary views about KAM in the audit planning
- Opportunities to obtain understand the basis for the auditor's decisions in related to KAM

Relationship with modified opinions



MODIFIED OPINION	KAM
QUALIFIED	Include the usual KAM section; AND Reference the Basis for Qualified Opinion in the KAM section. <i>"In addition to the matter described in the Basis for Qualified Opinion section, we have determined the matters described below to be the key audit matters to be communicated in our report."</i> [Description of each key audit matter]
ADVERSE	Include the usual KAM section; AND Reference the Basis for Adverse Opinion in the KAM section. <i>"In addition to the matter described in the Basis for Adverse Opinion section, we have determined the matters described below to be the key audit matters to be communicated in our report."</i> [Description of each key audit matter]
DISCLAIMER	There must not be a KAM section.

Interaction with going concern



If the use of the going concern basis of accounting is inappropriate	<ul style="list-style-type: none"> • An adverse opinion • A description of this circumstance in the <i>Basis for Adverse Opinion</i> section • Reference the <i>Basis for Adverse Opinion</i> in the KAM section
Appropriate going concern basis + going concern indicators	<ul style="list-style-type: none"> • An unmodified opinion • A section with a new required heading Material Uncertainty Related to Going Concern, with a reference to the note in the financial statements that describes the material uncertainty, and a statement that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.

Interaction with going concern



	<ul style="list-style-type: none"> • Reference the <i>Material Uncertainty Related to Going Concern</i> in the KAM section
	<p><i>“In addition to the matter described in the Material Uncertainty Related to Going Concern section we have determined the matters described below to be the key audit matters to be communicated in our report.”</i></p> <p>[Description of each key audit matter]</p>
<p>Appropriate going concern basis + going concern indicator + Inadequate or omitted disclosures</p>	<ul style="list-style-type: none"> • A qualified or adverse opinion as appropriate • A description of this circumstance in the <i>Basis for Qualified/Adverse Opinion</i> section • Reference the <i>Basis for Qualified/Adverse Opinion</i> in the KAM section

Interaction with going concern



<p>When the use of the going concern basis of accounting is appropriate but events or conditions were identified that may cast doubt on the entity’s ability to continue as a going concern but, based on the audit evidence obtained the auditor concludes that no material uncertainty exists</p>	<ul style="list-style-type: none"> • An unmodified opinion • Report as a KAM
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Exclusion from Key Audit Matters



Circumstances in Which a Matter Determined to Be a Key Audit Matter Is **Not Communicated in the Auditor's Report**

- Law or regulation precludes public disclosure about the matter
- Matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits – very rare case

Matter giving rise to a modified opinion under **HKSA 705 (Revised)** or a **going concern indicator under HKSA 570 (Revised)**

- Alright not described in KAM but rather
- Report in according to HKSA and include reference to the **Basis for Qualified (Adverse) Opinion or the Material Uncertainty Related to Going Concern section**

KAM for Smaller Entities



For smaller entities it may not be so immediately existing of KAM

- If the entity is not complex, and it is **not** a high-risk audit engagement, therefore **no KAM**
- Smaller entities may not have any significant risks except the **mandatory risk of management override of controls** and the **reputable presumption of risk of fraud in revenue recognition**, not sure of KAM or not
- KAM are broader than “**significant risks**”
- KAM may just be areas where you spent most of your time during the audit.

Examples wordings of KAM



Goodwill

The Group is required to annually test the amount of goodwill for impairment. This annual impairment test was significant to our audit because the assessment process is **complex and highly judgmental** and is based on assumptions that are affected by expected future market or economic conditions, particularly those in [*Countries X and Y*]. As a result, our audit procedures included, among others, using a valuation expert to assist us in evaluating the assumptions and methodologies used by the Group, in particular those relating to the forecasted revenue growth and profit margins. We also focused on the **adequacy of the Group's disclosures** about those **assumptions to which the outcome of the impairment test is most sensitive**, that is, those that have the most significant effect on the determination of the recoverable amount of goodwill.

Examples of KAM



Valuation of Financial Instruments

The Group's disclosures about its structured financial instruments are included in Note X. The Group's investments in structured financial instruments represent [x%] of the total amount of its financial instruments. Because the valuation of the Group's structured financial instruments is **not based on quoted prices in active markets**, there is **significant measurement uncertainty** involved in this valuation. As a result, the valuation of these instruments was significant to our audit. The Group has determined it is necessary to use an entity-developed model to value these instruments, due to their unique structure and terms. We challenged the **rationale for using an entity-developed model** and discussed this with the Board of Directors, and we concluded the use of such a model was appropriate. Our audit procedures also included, among others, testing the controls related to the development and calibration of the model and confirming that the directors had determined it was not necessary to make any adjustments to the output of the model to reflect the assumptions that marketplace participants would use in similar circumstances.

Examples of KAM



Acquisition of XYZ Business

As described in Note X, in December 2017, the Group completed the **acquisition of ABC Business**. ABC Business was a division of a large private company. As of 31 December 2017, the Group has completed the initial acquisition accounting on a preliminary basis. The Group will finalise the initial acquisition accounting during 2018, and the amounts recorded as of 31 December 2017 could change. We focused on this transaction because it is material to the consolidated financial statements as a whole and the fact that values had not previously been assigned to the division as a standalone operation. In addition, determining the assumptions that underlie the initial acquisition accounting and the useful lives associated with the acquired intangible assets involves significant judgment given the nature of the [*manufacturing of industry*].

Question - Marr



Question 1

You are an audit manager in Fender & Co, and have received a query from an audit senior on the subject of HKSA 701 *Communicating key audit matters in the independent auditor's report*.

'I have heard that this standard requires us to give several different auditor's opinions on each audit. I'm worried that we'll have to do a lot more audit work to obtain evidence for each key audit matter, and that it's pointless anyway because if these things were really important we would have included them in emphasis of matter paragraphs.'

Required

Respond to the audit senior's query, explaining the requirements of HKSA 701 where relevant.

(5 marks)

Question - Marr

Question 2



You are an audit manager in Taylor & Co, a firm of Chartered Certified Accountants, responsible for the audit of Marr Co, with a year ended 28 February 20X4. The draft financial statements recognise profit for the year of \$11 million. The audit for the year end is nearing completion, and several matters have been highlighted for your attention by the audit senior, Xi Smith. The matters have been discussed with management and will not be adjusted in the financial statements:

- 1) In January 20X4 a major customer went into administration. There was a balance of \$2.5 million owing to Marr Co from this customer at 28 February 20X4, which is still included in trade receivables.
- 2) A court case began in December 20X3 involving an ex-employee who is suing Marr Co for unfair dismissal. Lawyers estimate that damages of \$50,000 are probable to be paid. The financial statements include a note describing the court case and quantifying the potential damages but no adjustment has been made to include it in the statement of financial position or the statement of profit or loss.

Question - Marr

Question 2 (Cont'd)



Xi Smith has produced a draft auditor's report for your review, an extract of which is shown below:

Basis for opinion and disclaimer of opinion

We have performed our audit based on a materiality level of \$1.5 million. Our audit procedures have proven conclusively that trade receivables are materially misstated. The finance director of Marr Co, Rita Gilmour, has refused to make an adjustment to write off a significant trade receivables balance. Therefore, in our opinion the financial statements of Marr Co are materially misstated and we therefore express a disclaimer of opinion because we do not think they are fairly presented.

Question - Marr

Question 2 (Cont'd)



Emphasis of Matter paragraph

Marr Co is facing a legal claim for an amount of \$50,000 from an ex-employee. In our opinion this amount should be recognised as a provision but it is not included in the statement of financial position. We draw your attention to this breach of the relevant HKFRS.

Required

Critically appraise the proposed auditor's report of Marr Co for the year ended 28 February 20X4.

Note. You are NOT required to re-draft the extracts from the auditor's report.

(10 marks)

Answer - Marr

Answer 1



The query contains three elements: the relationship between Key Audit Matters (KAMs) and the auditor's opinion, audit work, and emphasis of matter paragraphs.

Multiple opinions

HKSA 701 *Communicating key audit matters in the independent auditor's report* is clear that including KAMs does not mean expressing separate auditor's opinions on each issue. Rather, the auditor's opinion relates to the financial statements as a whole, and the KAMs are explanations of the matters of most significance to that audit. KAMs relate to the individual matters which underpin the auditor's opinion overall.

Audit work

The inclusion of KAMs in the auditor's report is the result of an attempt by the IAASB to make better use of the information obtained by the auditor during the normal audit process. Including KAMs in an auditor's report should therefore not involve 'a lot' more audit work. This is because the KAMs are matters which the auditor should already have considered and obtained evidence about.

Answer - Marr



Answer 1 (Cont'd)

In fact, the KAMs are merely the most significant matters which have been selected from those being communicated to those charged with governance at the end of the audit. Including them in the auditor's report should not involve obtaining any more audit evidence because this evidence should already have been obtained.

Emphasis of matter (EoM) paragraphs

The senior is correct to note the similarity between KAMs and EoM paragraphs. They both refer to matters already included in the financial statements, and neither modifies the auditor's opinion. However, there is a crucial difference between them: KAMs are included in every auditor's report where HKSA 701 applies, whereas EoM paragraphs are only included in particular circumstances. KAMs are part of the standard unmodified auditor's report, but an EoM paragraph modifies the auditor's report.

Answer - Marr



Answer 1 (Cont'd)

KAMs are defined as the 'matters of most significance to the audit', whereas EoMs are 'fundamental for users' understanding'. EoMs deal with exceptional matters that users must understand if they are to understand the financial statements. The EoM paragraph deals with the matter itself; KAMs do this, but will also focus on the audit process (and judgements made). HKSA 701 requires auditors to choose whether a matter is a KAM or requires an EoM paragraph (it cannot be both), depending mainly on its importance for users' understanding.

The point of KAMs is to provide users with additional information about the normal audit process, which should improve users' understanding of the entity's financial position and performance, and of the audit process. This is part of the general effort of regulators to raise audit quality, which is arguably vital if the audit profession as a whole is to remain of relevance to the modern world.

Answer - Marr

Answer 2



There are several problems with the draft auditor's report.

Layout

The draft report contains a paragraph entitled 'Basis for opinion and disclaimer of opinion'. HKSA's require two separate paragraphs here, headed 'Basis for Opinion' and 'Opinion'. The 'Basis for Opinion' paragraph is placed immediately before the 'Opinion' paragraph, and its heading reflects the type of opinion being given-hence 'Basis for Qualified Opinion', 'Basis for Adverse Opinion', and so on.

Wording of report

The paragraph states the materiality level used, which is not required by HKSA's. All that is needed here is a description of the scope of the audit.

Answer - Marr

Answer 2 (Cont'd)



The paragraph states that 'procedures have proven conclusively that trade receivables are materially misstated'. This is misleading. Audit procedures provide reasonable assurance, which is less than the absolute assurance implied by the words 'proven conclusively'.

The basis for modification paragraph should state the amount of the potential adjustment to receivables, along with its financial impact, referring to the relevant financial reporting standard.

The paragraph names the finance director, which is unnecessary and unprofessional. The statement that she 'refused to make an adjustment' is inflammatory and may leave the auditor open to legal action.

Answer - Marr

Answer 2 (Cont'd)



Opinion

An inappropriate auditor's opinion has been given here. At 23% of profit, any write-off of the receivable would be material. The draft report is therefore correct inasmuch as an unmodified opinion would be inappropriate because a material amount of the balance should be written-off.

However, the receivable is unlikely to be judged as pervasive to the financial statements, so the level of modification is wrong. Further, there has been no inability to obtain sufficient appropriate audit evidence, as would be implied by a disclaimer of opinion - as the draft report states, this is a material misstatement.

The opinion should be qualified on the grounds of there being a material misstatement.

Answer - Marr

Answer 2 (Cont'd)



Emphasis of Matter (EoM)

The use of an EoM paragraph is inappropriate. An EoM is used to refer to a matter which is already correctly disclosed in the financial statements, but which is in need of extra emphasis by the auditor. By contrast, here the EoM refers to a provision not included in the financial statements. In reality this is a misstatement.

The \$50,000 is not material, so the draft report is correct not to modify the opinion in this respect. The correct course of action would be to ask Marr Co to provide for this amount, and if they do not then keep track of it as an uncorrected misstatement. Although it is immaterial on its own, it may become material alongside other uncorrected misstatements.



HKSA 720 (Revised) The auditor's responsibilities relating to other information

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HKSA 720 (Revised)



In August 2015, HKICPA issued HKSA 720 (Revised) *The Auditor's Responsibilities to Other Information*. The key changes are a clarification of the definition of 'other information', an enhancement of the work carried out by the auditor and a requirement for including in the auditor's report a separate Other Information section when other information exists.

The auditor shall consider whether there is a **material inconsistency** between

- (i) the other information and the financial statements; and
- (ii) the other information and the auditor's knowledge obtained in the audit,

and respond and report appropriately under HKSA 720 (Revised).

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HKSA 720 (Revised)



Other information is financial or non-financial information (other than financial statements and the auditor's report thereon) included in an entity's annual report.

Auditors have **no responsibility** to report that other information is properly stated because an audit is only an expression of opinion on the truth and fairness of the financial statements.

The auditors should give consideration to other information as **inconsistencies with the audited financial statements** may undermine their opinion.

The auditor shall **read** the other information and consider whether there are material inconsistencies.

HKSA 720 (Revised)



If, on reading the other information, the auditor identifies that a material inconsistency appears to exist (or becomes aware that the other information appears to be materially misstated), the auditor shall **discuss the matter with management** and, if necessary, perform other procedures to conclude whether:

- A material misstatement of the other information exists;
- A material misstatement of the financial statements exists; or
- The auditor's understanding of the entity and its environment needs to be updated.

HKSA 720 (Revised)



Revision needed to other information

If the other information is **not corrected** after communicating with those charged with governance, the auditor will consider the implication for the auditor's report or withdraw from the engagement.

The exact course of action will be down to the auditor's professional judgment.

The auditor may consider whether the rationale of management and those charged with governance for not making the correction implies a lack of management integrity. The auditor may wish to **obtain legal advice**.

HKSA 720 (Revised)



Audit Reporting

Where an **unmodified opinion** is expressed and the **other information is not materially misstated**, the standard unmodified Other Information section is placed after the Key Audit Matters section.

Other Information

The directors are responsible for the other information. The other information comprises the [information included in the X report, but does not include the financial statements and our auditor's report thereon.]

HKSA 720 (Revised)



Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

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Corporate Governance



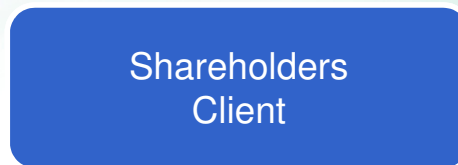
MC - Corporate Governance



Why Corporate Governance?

Principal L-T

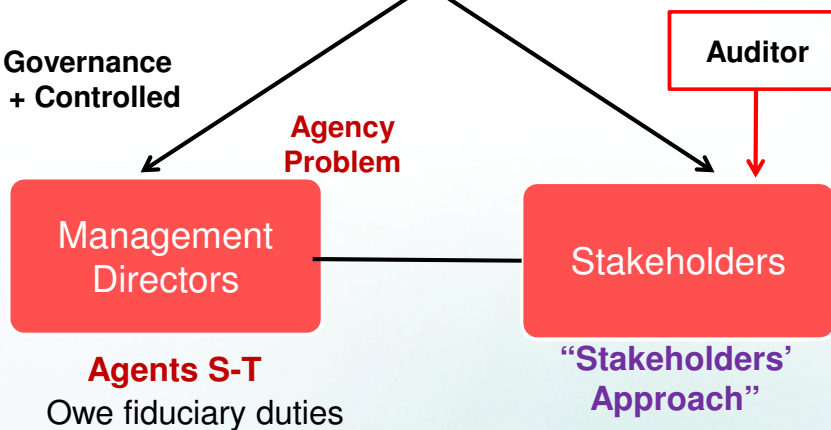
Resolve by
Alignment of
interest



Agency Costs

- Audit fee
- IA costs

Corporate Governance
→ Directed + Controlled



MC - Corporate Governance



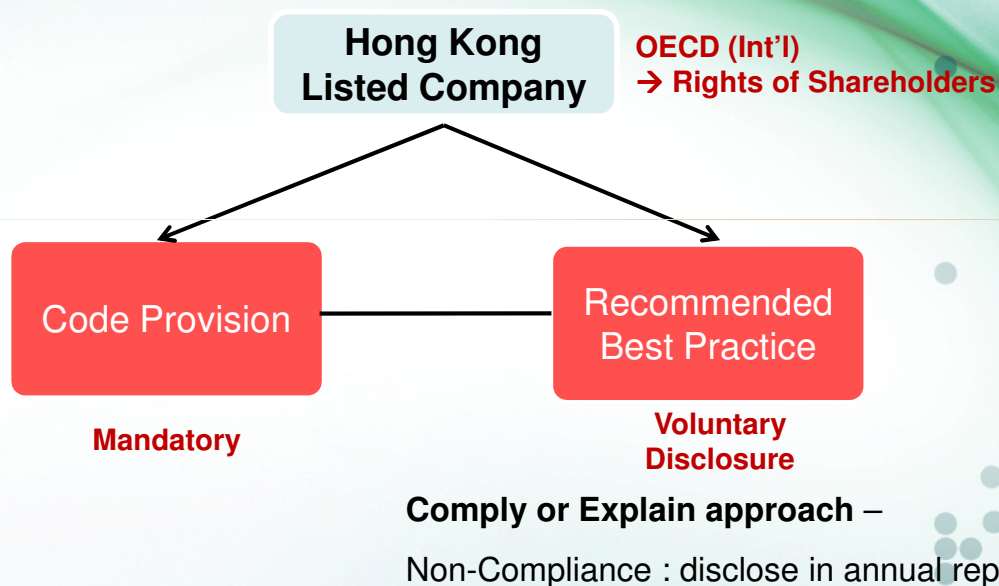
Major Concepts of Corporate Governance

- Ethics → Business ethics
- Transparency → Annual report
→ Attract shareholders
- Safeguard assets → Fraud
- Comply with laws + Regulations → Listing rules
- Strong internal control + Risk management
- International investors → Pay premium
- Enhance shareholders' value

MC - Corporate Governance



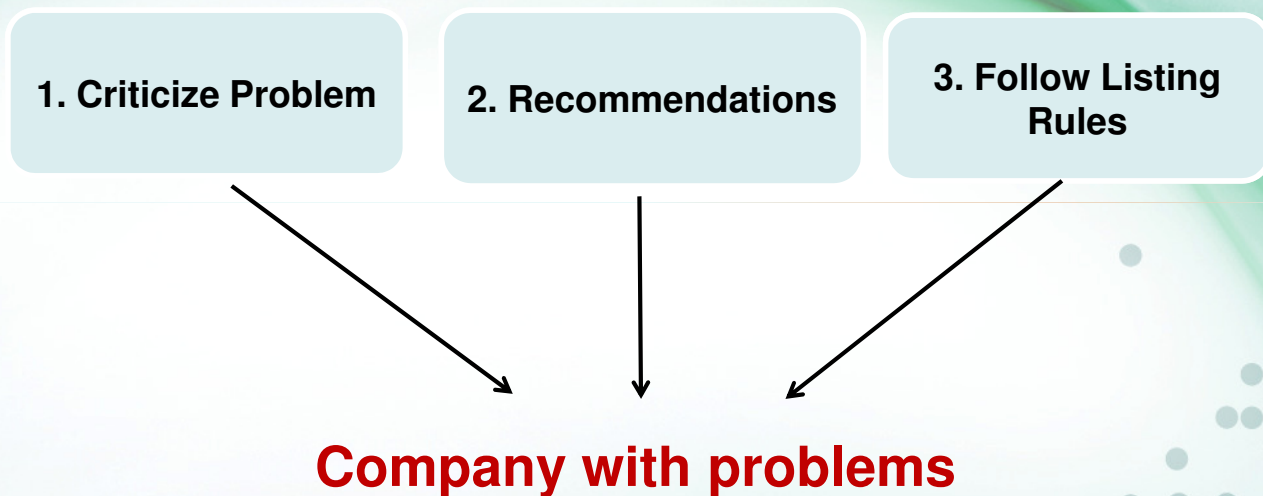
Hong Kong Listed Companies



MC - Corporate Governance



Exam Technique



MC - Corporate Governance



Corporate Governance Concepts I

- **The Board** – effective board / **active interest in the issuer's affairs**
- **Chairman and Chief Executive Officer** – separated a clear division of these responsibilities at the board level.
- **Board composition** – balance of skills and experience appropriate; The new Rule required that at least **one-third** of an issuer's board should be **independent non-executive directors (INEDs)**.

MC - Corporate Governance



Corporate Governance Concepts I

- **Appointments, re-election and removal** – formal, considered and transparent procedure for the appointment of new directors to the board.
- **List of directors should be published on the issuer's website**

MC - Corporate Governance



Corporate Governance Concepts II

- **An INED who has served nine years**
- **Separate resolution to retain an INED who has served on the board for more than nine years.**
- **Directors should provide records of training they received to issuers.**
- **Board should regularly review the contribution by a director.**

MC - Corporate Governance



Corporate Governance Concepts II

- **Supply of and access to information** – Directors should be provided in a timely manner with appropriate information.
- **The board should be responsible for corporate governance.**
- Non-executive directors, including INEDs, should attend board, committee and general meetings and contribute to the issuer's strategy and policies.

MC - Corporate Governance



Corporate Governance Concepts III

- **Directors – Remuneration of directors and senior management and Board Evaluation**
- Disclose information relating to its **directors' remuneration policy** and other remuneration related matters. (Disclosed in full in the annual reports and Accounts)
- The company should establish a **remuneration committee**
- **Formal and transparent procedure** for setting policy on executive directors' remuneration

MC - Corporate Governance



Corporate Governance Concepts III (Cont'd)

- Fixing the **remuneration packages** for all directors
- A significant proportion of executive directors' remuneration should be structured so as to **link rewards** to corporate and individual performance.
- Directors' fees and any other **reimbursement or emolument payable to a director must be disclosed in full in the annual reports and accounts** of the issuer on an individual and named basis.
- Basic salary + ST and LT bonus + Share Awards and Share options

MC - Corporate Governance



Corporate Governance Concepts IV

- **Audit Committee** – The board should establish **formal and transparent arrangements** for considering how it will apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the company's auditors.
- Listed company should establish a **shareholder communication policy**.

MC - Corporate Governance



Corporate Governance Concepts IV

- **Company Secretary**
- The Company Secretary supports the Chairman in **promoting** the highest standards of corporate governance.
- **Ensuring good information flow** within the board and that board policy and procedures are followed.
- The Company Secretary **reports to the Chairman**

MC - Corporate Governance



Corporate Governance Concepts V

- **Auditor attending the AGM**
- The management of a company should ensure the **company's auditor attends the annual general meeting ("AGM")** to answer questions relevant to:
 - the conduct of the audit – responses to questions about the **conduct of the audit**
 - the **preparation and content of the auditor's report;**
 - the **accounting policies** adopted by the company in relation to the preparation of the financial statements; and
 - the **independence** of the auditor in relation to the conduct of the audit.
 - **Modification** to the independent auditor's report, if any

MC - Corporate Governance



NEW in Corporate Governance

Board Diversity (“BD”)

Implement new measures. In brief, the measures include a Code Provision (“CP”) which requires the issuer to have a BD policy, and disclose the policy or its summary in the issuer's corporate governance report, along with any measurable objectives for implementing the policy and progress on achieving those objectives.

Diversity of board members can be achieved through consideration of a number of factors, including but not limited to gender, age, cultural and educational background, or professional experience.

MC - Corporate Governance



Corporate Governance

The New Hong Kong Companies Ordinance

The new CO Commenced operation from 3 March 2014.

Under the new CO, there are new measures for enhancing corporate governance and the following are some of the major measures for the enhancement :

MC - Corporate Governance



Corporate Governance

a) Strengthening the accountability of directors

Restricting the appointment of corporate directors by requiring every private company to have **at least one natural person** to act as director, to enhance transparency and accountability.

Clarifying in the statute the directors' duty of care, skill and diligence with a view to providing clear guidance to directors.

MC - Corporate Governance



Corporate Governance

b) Enhancing shareholder engagement in the decision-making process

Introducing a **comprehensive set of rules for proposing and passing a written resolution.**

Requiring a company to bear the expenses of circulating members' statements relating to the business of, and proposed resolutions for, Annual General Meetings, if they are received in time to be sent with the notice of the meeting.

Reducing the threshold requirement for members to demand a poll from 10% to 5% of the total voting rights.

MC - Corporate Governance



Corporate Governance

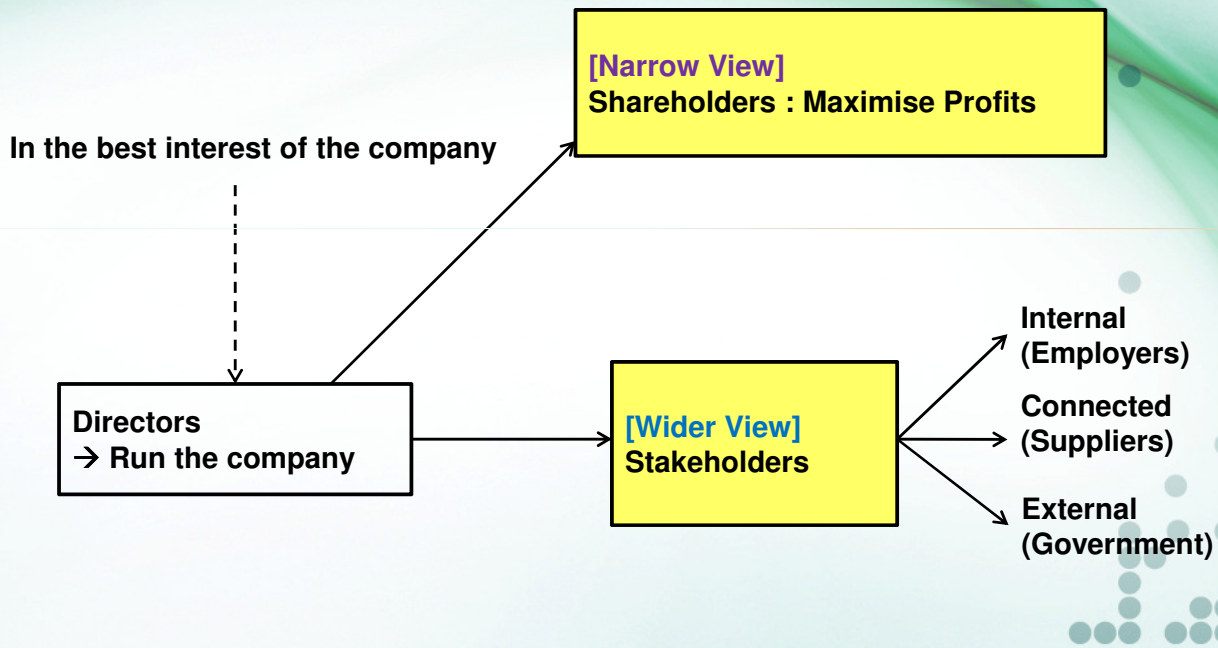
c) Improving the disclosure of company information

Requiring public companies and the larger (ie companies that do not qualify for simplified reporting) private companies and guarantee companies to **prepare a more comprehensive directors' report** which includes an analytical and forward-looking "business review", whilst allowing private companies to opt out by special resolution. The business review will provide useful information for shareholders. In particular, the requirement to include information relating to environmental and employee matters that have a significant effect on the company is in line with international trends to promote corporate social responsibility.

MC - Corporate Governance



Stakeholders – Narrow View Vs Wider View



MC - Corporate Governance



Open Question –

Does the Company need to adopt stakeholder's approach?

Yes

- Trend → Globally
- Corporate social responsibility
- Attract shareholders
- Increasing internationalization
- Avoid corporate scandals

No

- Too wide
- Too costly to suit everyone
- No legitimate effects – ie no economic benefits
- Culture differences

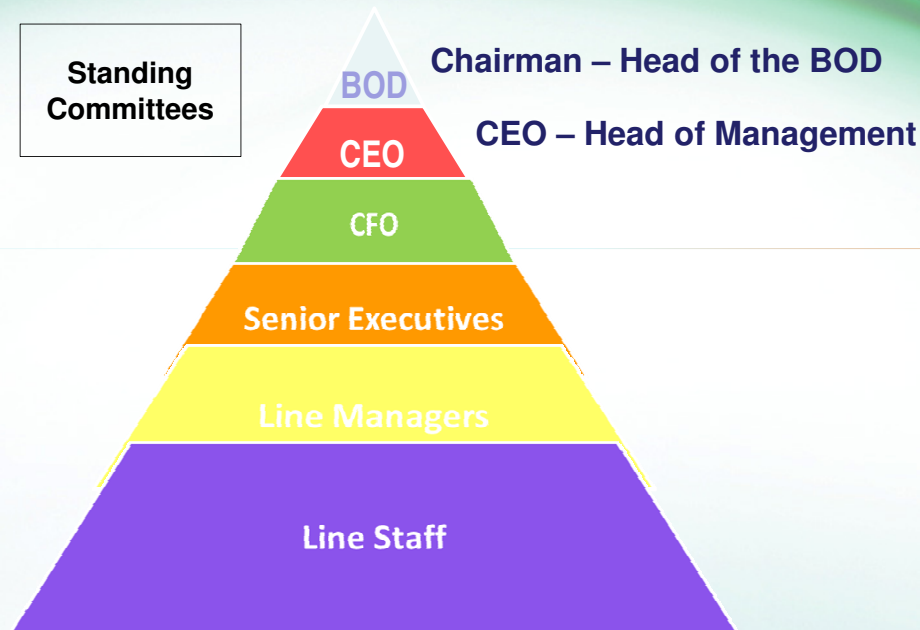
MC - Corporate Governance



Chairman Vs CEO

“Chairman ≠ CEO”

Standing
Committees



MC - Corporate Governance



Chairman's Role

- leader of the board of directors in a private or public company
- responsible for ensuring the board's effectiveness
- setting the board's agenda and ensuring that board meetings take place
- “public face” of the organisation
- communication with shareholders.
- co-ordinating the contributions of non-executive directors (NEDs) and facilitating good relationships between executive and non-executive directors.

MC - Corporate Governance



Standing Committees

Nomination Committee

- NEDs - majority of INEDs
- Nominate directors
- Recommendation to BOD

Remuneration Committee

- NEDs
- Remuneration policy
- Remuneration procedures

Audit Committee

- NEDs
- Deal with external auditors
- Formal transparent appointment of auditors

Risk Committee

- EDs and NEDs
- Risk policies
- Risk responses

MC - Corporate Governance



The Board

EDs

- Implement strategies
- Setting strategies
- Implementing internal controls
- Monitor controls

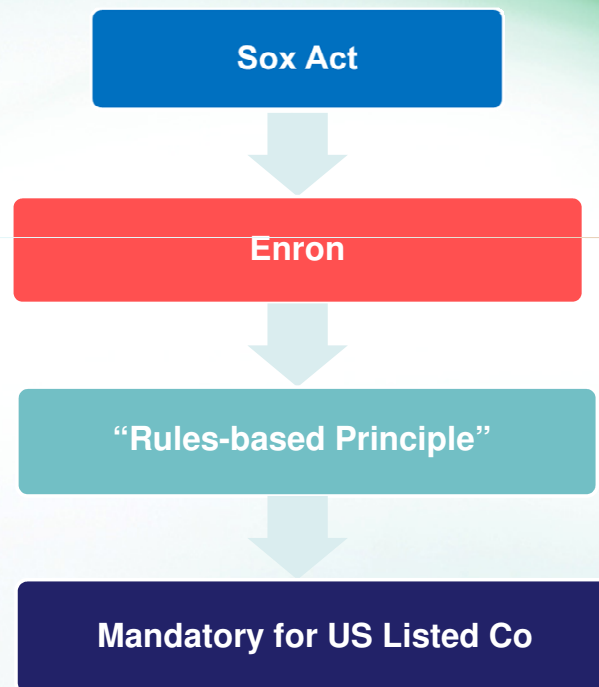
NEDs

- Review / Monitor / Recommendation to BOD
- Board Committee
 - Nomination
 - Remuneration
 - Audit
 - Risk
 - Fixed fee
 - No performance related pay ie bonus or share options

MC - Corporate Governance



Sarbanes - Oxley Act 2002



MC - Corporate Governance



Major Concepts in SOX

- New Regulator → Public Oversight Board (“PCAOB”)
- Regulate Audit Firms
 - Retain working papers 7 years
 - Prohibit other non audit services
 - Rotate Partner every 5 years
 - Audit Committee (**MUST**)
- CEO + CFO – certify FS – forfeit their bonuses
- Disclose off-balance sheet item
- Adequate IC reporting
- Whistle blowing



Exam Questions Review Dec 2016 – SQ 6

Corporate Governance

MC – Exam Questions Review

Question

The Code on Corporate Governance Practices (the “HK Code”) published by the Hong Kong Stock Exchange contains a combination of broad principles, specific code provisions and recommended best practices.

Company A is a garment manufacturing company and plans for an initial public offering (“IPO”) in the coming year. Company A is primarily owned by Mr Lee and Mr Chung who are the Chairman and Chief Executive Director (“CEO”) of Company A respectively. You are the auditor of Company A. During the audit planning meeting, Mr Lee and Mr Chung seek your advice as to how Company A should comply with the HK Code to prepare Company A to be listed on the Hong Kong Stock Exchange.

Company A’s board of directors consists of seven members including Mr Lee, Mr Chung and one independent non-executive director that meets on a regular basis to discuss key business matters. Company A’s board of directors consists of members who have extensive experience in the textiles industry and strong finance backgrounds.

MC – Exam Questions Review



Question (Cont'd)

Company A has an internal audit team but has yet to set up any audit committee or any other committees to support the board. The head of the internal audit team reports directly to Mr Lee. Company A's company secretary is a third party service provider who provides Mr Lee and Mr Chung with the latest corporate governance information on a regular basis.

The prior year audit evidenced that Company A has set a good practice at the top and introduced a clear business code of conduct to all of its employees. The tests of controls also indicated that Company A's key controls over financial reporting were effective.

MC – Exam Questions Review



Question (Cont'd)

Required:

- a) **Explain the current approach required by the Hong Kong Stock Exchange for a listed company in Hong Kong when applying the HK Code.**
(2 marks)
- b) **Identify elements which indicate that Company A is in compliance with the HK Code.**
(4 marks)
- c) **Recommend how Company A can improve its corporate governance for the preparation of the IPO.**
(4 marks)

MC – Exam Questions Review



Answer (a)

The listed companies in Hong Kong are required to adopt the “comply or explain” approach to the HK Code. They are required to confirm their compliance with the HK Code or, where they do not comply, to provide explanations for any variation in practice.

Answer (b)

The following indicates that Company A is in compliance with the HK Code:

- Company A has a balanced board of directors which is evidenced by the following:
 - Company A’s board of directors consists of different members who have relevant expertise and experience in the garment manufacturing / textiles industry. The board also consists of members who have expertise in finance.

MC – Exam Questions Review



Answer (b) (Cont'd)

- Company A’s board of directors also meets regularly to discuss key business matters.
 - Company A’s Chairman and CEO are different persons. Mr Lee and Mr Chung are the Chairman and CEO of Company A respectively so they can balance the power of each other in the board.
- Company A maintains a sound system of internal control to safeguard shareholder’s investment and the company’s assets which is evidenced by the following:
- Company A has an internal audit team, with good practice at the top and clear business code of conduct to employees.
 - The prior year audit also indicated that Company A’s key controls over financial reporting were effective.

MC – Exam Questions Review



Answer (c)

The recommendations should include:

- At least one-third of an issuer's board should be independent non-executive directors. Company A has only one independent non-executive director out of seven board of directors. Company A should consider increasing the number of independent non-executive directors in the composition of the board.
- Company A should set up an audit committee, nomination committee and a remuneration committee which consist of independent non-executive directors.
- Company A's internal audit team should report to the audit committee but not report to Mr Lee directly.

MC – Exam Questions Review



Answer (c) (Cont'd)

The recommendations should include:

- Company A should hire an in-house company secretary who has day-to-day knowledge of Company A's affairs but not out-source the company secretary's role to a third party service provider.
- The company secretary should provide advice to the board on board procedures and ensure the board follows applicable law, rules and regulations. The company secretary should not just report to Mr Lee and Mr Chung.



Exam Questions Review

Dec 2011 – Case Qu 3

Corporate Governance

MC – Exam Questions Review



[Corporate Governance]
Dec 2011 – Case Qu 3 (Extracted)

Question

Dummy Real Estate Investment Trust (DREIT) is a mid-size real estate investment trust listed in Hong Kong. With a portfolio of 50 real estates comprising retail malls, commercial premises and car park facilities, DREIT was established by a trust deed (Trust Deed)

Since its listing on the Hong Kong Stock Exchange in December 2008, DREIT has been paying the Unitholders at about 90% of its net income and has demonstrated consistent growth in distribution per unit.

MC – Exam Questions Review



[Corporate Governance] Dec 2011 – Case Qu 3 (Extracted)

Required:

DREIT has established an audit committee to comply with the Listing Rules of the Hong Kong Stock Exchange.

- a) To what extent can the establishment of an effective audit committee improve DREIT's corporate governance in the context of external auditing, financial reporting and internal control? (8 marks)
- b) Describe some ways to gauge the effectiveness of DREIT's audit committee. (6 marks)

MC – Exam Questions Review



[Corporate Governance] Dec 2011 – Case Answer 3a

An effective audit committee can enhance the **effectiveness, accountability, transparency and objectivity** of the Manager's Board of Directors, and can also improve DREIT's corporate governance in the following ways:

MC – Exam Questions Review



[Corporate Governance]

Dec 2011 – Case Answer 3a (Cont'd)

Financial reporting

- Improve the quality of financial reporting by reviewing the financial statements on behalf of DREIT's Board of Directors.
- Increase the involvement of the non-executive directors by assigning them to the audit committee to contribute independent viewpoints.
- Increase public confidence by raising the credibility and objectivity of DREIT's financial statements.

MC – Exam Questions Review



[Corporate Governance]

Dec 2011 – Case Answer 3a (Cont'd)

External auditing

- Strengthen the position of DREIT's external auditor by providing an open channel of communication.
- Formulate a framework for DREIT's external auditor to maintain its independence when there are disputes with DREIT's management.

MC – Exam Questions Review



[Corporate Governance] Dec 2011 – Case Answer 3a (Cont'd)

Internal control

- Strengthen the position of DREIT's internal auditor by separating it from executive management.
- Foster a culture of self-discipline, risk alertness and anti-fraud controls.
- Create a forum for DREIT's internal auditor in which they can raise issues of concern, and which they can use to get things done which might otherwise be difficult.

MC – Exam Questions Review



[Corporate Governance] Dec 2011 – Case Answer 3b

The **effectiveness of DREIT's audit committee** may be gauged in the following ways:

The Manager's Board of Directors is equivalent to DREIT's governing body which should have a balanced composition of executives and non-executives (to maintain objectivity) drawing from a range of relevant expertise. As a subset of the Board, the audit committee should consist entirely of non-executive directors (at least 3) particularly in the fields of accounting and finance. Also, some directors should have no financial interest in DREIT in order to maintain their independence. **(1/3 of Board = INED)**

MC – Exam Questions Review



[Corporate Governance]

Dec 2011 – Case Answer 3b (Cont'd)

Adequate resources should be set aside for the audit committee, so that an adequate number of members with the right calibre are appointed for access to management, external auditors and internal auditors.

DREIT's audit committee with proper terms of reference derives its authority from DREIT's Board of Directors under the requirements of the Listing Rules. Without proper authority, an audit committee would not be able to exercise the appropriate influence

MC – Exam Questions Review



[Corporate Governance]

Dec 2011 – Case Answer 3b (Cont'd)

DREIT's audit committee should be diligence which refers to the extent of willingness that DREIT's audit committee members work together to fulfill the requirements, including background study of agenda items, preparation of questions, checking progress, understanding problems and dealing with DREIT's management, internal auditors, external auditors and other stakeholders.

MC Exam Skills



1. Identify audit issues in the case
2. Count the marks
3. Use auditing wordings
4. Writing skills
5. Cross over standards
6. Practical audit procedures
7. Time management

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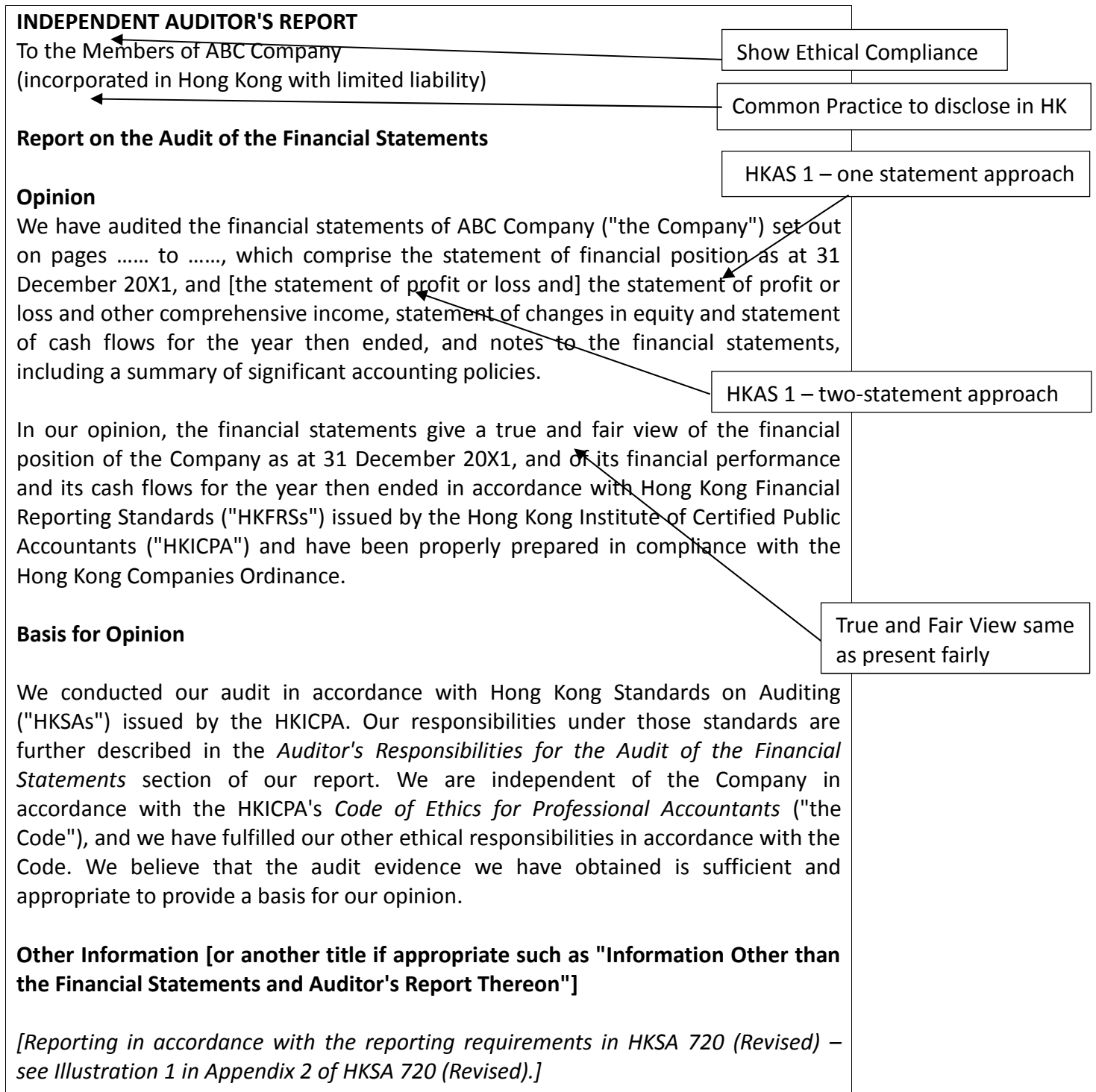
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Unmodified Report – Company Level

Ref : HKSA 700 (Revised) - Illustration 3 – Auditor's Report for an Entity Other than a Listed Entity Incorporated in Hong Kong and where the Financial Statements are Prepared in Accordance with Hong Kong Financial Reporting Standards



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

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

Directors responsible for internal control

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

HKSA 570 – Consider the use of going concern assumption

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

Auditor's Responsibilities for the Audit of the Financial Statements

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

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities prescribed by local law or regulation. The matters addressed by other law or regulation (referred to as "other reporting responsibilities") shall be addressed within this section unless the other reporting responsibilities address the same topics as those presented under the reporting responsibilities required by the HKSAs as part of the Report on the Audit of the Financial Statements section. The reporting of other reporting responsibilities that address the same topics as those required by the HKSAs may be combined (i.e., included in the Report on the Audit of the Financial Statements section under the appropriate subheadings) provided that the wording in the auditor's report clearly differentiates the other reporting responsibilities from the reporting that is required by the HKSAs where such a difference exists.]

Refer to HKSA 705 (Revised)

XYZ & Co.
Certified Public Accountants (Practising) or Certified Public Accountants
[Auditor Address]
[Date]

Appendix to the auditor's report (Optional)

As part of an audit in accordance with HKSA's, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and **assess the risks of material misstatement** of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an **understanding of internal control** relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of **accounting estimates** and related disclosures made by the directors.
- Conclude on the **appropriateness of the directors' use of the going concern** basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the **overall presentation, structure and content** of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

No audit opinion on internal control

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Modified Report

Ref : HKSA 705 (Revised) - Illustration 1 – Qualified Opinion due to a Material Misstatement of the Financial Statements

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company
(incorporated in Hong Kong with limited liability)

Report on the Audit of the Financial Statements

Indicating the type of modification

Qualified Opinion

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

Relate to the Basis for Qualified Opinion Paragraph

In our opinion, **except for** the effects of the matter described in the *Basis for Qualified Opinion* section of our report, the financial statements give a true and fair view of the financial position of the Company as at 31 December 20X1, and of its financial performance and its cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Reasons for the modifications

Basis for Qualified Opinion

The Company's inventories are carried in the statement of financial position at xxx. The directors have not stated the inventories at the lower of cost and net realizable value but have stated them solely at cost, which constitutes a departure from HKFRSs. The Company's records indicate that, had the directors stated the inventories at the lower of cost and net realizable value, an amount of xxx would have been required to write the inventories down to their net realizable value. Accordingly, cost of sales would have been increased by xxx, and income tax, net income and shareholders' equity would have been reduced by xxx, xxx and xxx, respectively.

Financial effects of material misstatements

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

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

[Reporting in accordance with the reporting requirements in HKSA 720 (Revised) – see Illustration 6 in Appendix 2 of HKSA 720 (Revised). The last paragraph of the other information section in Illustration 6 would be customized to describe the specific matter giving rise to the qualified opinion that also affects the other information.]

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. In addition to the matter described in the *Basis for Qualified Opinion* section we have determined the matters described below to be the key audit matters to be communicated in our report.

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

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

[Reporting in accordance with HKSA 700 (Revised) – see Illustration 1 in HKSA 700 (Revised).]

Auditor's Responsibilities for the Audit of the Financial Statements

Report on Other Legal and Regulatory Requirements

[Reporting in accordance with HKSA 700 (Revised) – see Illustration 1 in HKSA 700 (Revised).]

The engagement partner on the audit resulting in this independent auditor's report is [name].

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[Auditor Address]

[Date]

Ref : HKSA 705 (Revised) - Illustration 2 –Adverse Opinion due to a Material Misstatement of the Consolidated Financial Statements

<p>INDEPENDENT AUDITOR'S REPORT To the Members of ABC Company (incorporated in Hong Kong with limited liability)</p>	
<p>Report on the Audit of the Consolidated Financial Statements</p>	<p>Change the heading</p>
<p>Adverse Opinion</p>	
<p>We have audited the consolidated financial statements of ABC Company and its subsidiaries ("the Group") set out on pages to, which comprise the consolidated statement of financial position as at 31 December 20X1, and [the consolidated statement of profit or loss and] the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.</p>	<p>Illustrate the significance</p>
<p>In our opinion, because of the significance of the matter discussed in the <i>Basis for Adverse Opinion</i> section of our report, the consolidated financial statements do not give a true and fair view of the consolidated financial position of the Group as at 31 December 20X1, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"). In all other respects, in our opinion the consolidated financial statements have been properly prepared in compliance with the Hong Kong Companies Ordinance.</p>	<p>FS not giving a true and fair view</p>
<p>Basis for Adverse Opinion</p>	<p>Opinion is still given</p>
<p>As explained in Note X, the Group has not consolidated subsidiary DEF Company that the Group acquired during 20X1 because it has not yet been able to determine the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This investment is therefore accounted for on a cost basis. Under HKFRSs, the Company should have consolidated this subsidiary and accounted for the acquisition based on provisional amounts. Had DEF Company been consolidated, many elements in the consolidated financial statements would have been materially affected. The effects on the consolidated financial statements of the failure to consolidate have not been determined.</p>	<p>Still can refer to a Note</p>
	<p>Indicate the pervasiveness ie "many elements"</p>

Executive Training Company (International) Limited

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

Still need to mention that the auditors have obtained sufficient and appropriate audit evidence

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

[Reporting in accordance with the reporting requirements in HKSA 720 (Revised) – see Illustration 7 in Appendix 2 of HKSA 720 (Revised). The last paragraph of the other information section in Illustration 7 would be customized to describe the specific matter giving rise to the qualified opinion that also affects the other information.]

Key Audit Matters

Except for the matter described in the *Basis for Adverse Opinion* section, we have determined that there are no other key audit matters to communicate in our report.

Responsibilities of Directors and Those Charged with Governance for the Consolidated Financial Statements

[Reporting in accordance with HKSA 700 (Revised) – see Illustration 2 in HKSA 700 (Revised).]

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

[Reporting in accordance with HKSA 700 (Revised) – see Illustration 2 in HKSA 700 (Revised).]

Report on Other Legal and Regulatory Requirements

[Reporting in accordance with HKSA 700 (Revised) – see Illustration 2 in HKSA 700 (Revised).]

The engagement partner on the audit resulting in this independent auditor's report is [name].

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[Auditor Address]

[Date]

Ref : HKSA 705 (Revised) - Illustration 3 –Qualified Opinion due to the Auditor's Inability to Obtain Sufficient Audit Evidence Regarding a Foreign Associate

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company
(incorporated in Hong Kong with limited liability)

Report on the Audit of the Consolidated Financial Statements

Qualified Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries ("the Group") set out on pages to, which comprise [the consolidated statement of profit or loss and] the consolidated statement of financial position as at 31 December 20X1, and the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

Indication of
except for

In our opinion, **except for** the possible effects of the matter described in the *Basis for Qualified Opinion* section of our report, the consolidated financial statements give a true and fair view of the financial position of the Group as at 31 December, 20X1, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Qualified Opinion

The Group's investment in DEF Company, a foreign associate acquired during the year and accounted for by the equity method, is carried at xxx on the consolidated statement of financial position as at 31 December 20X1, and ABC's share of DEF's net income of xxx is included in ABC's income for the year then ended. **We were unable to obtain sufficient appropriate audit evidence** about the carrying amount of ABC's investment in DEF as at 31 December 20X1 and ABC's share of DEF's net income for the year because we were denied access to the financial information, management, and the auditors of DEF. **Consequently, we were unable to determine whether any adjustments to these amounts were necessary.**

Describe the
limitation on scope

Executive Training Company (International) Limited

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

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

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. **In addition to the matter described in the Basis for *Qualified Opinion* section, we have determined the matters described below to be the key audit matters to be communicated in our report.**

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

Responsibilities of Directors and Those Charged with Governance for the Consolidated Financial Statements

[Reporting in accordance with HKSA 700 (Revised) – see Illustration 2 in HKSA 700 (Revised).]

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

[Reporting in accordance with HKSA 700 (Revised) – see Illustration 2 in HKSA 700 (Revised).]

No need to include the points already described in the Basis for Qualified Opinion

Report on Other Matters under sections 407(2) and 407(3) 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 as described in the Basis for *Qualified Opinion* section of our report above:

- we were unable to determine whether adequate accounting records had been kept; and
- we have not obtained all the information or explanations that, to the best of our knowledge and belief, are necessary and material for the purpose of the audit.

The engagement partner on the audit resulting in this independent auditor's report is *[name]*.

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[Auditor Address]

[Date]

Ref : HKSA 705 (Revised) - Illustration 4 - Disclaimer of Opinion due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence about a Single Element of the Consolidated Financial Statements

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company
(incorporated in Hong Kong with limited liability)

Report on the Audit of the Consolidated Financial Statements

Disclaimer of Opinion

We were engaged to audit the consolidated financial statements of ABC Company and its subsidiaries ("the Group") set out on pages to, which comprise the consolidated statement of financial position as at 31 December 20X1, and [the consolidated statement of profit or loss and] the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

No opinion given

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

Basis for Disclaimer of Opinion

The Group's investment in its joint venture DEF Company is carried at xxx on the Group's consolidated statement of financial position, which represents over 90% of the Group's net assets as at 31 December 20X1. We were not allowed access to the management and the auditors of DEF Company, including DEF Company's auditors' audit documentation. As a result, we were unable to determine whether any adjustments were necessary in respect of the Group's proportional share of DEF Company's assets that it controls jointly, its proportional share of DEF Company's liabilities for which it is jointly responsible, its proportional share of DEF's income and expenses for the year, and the elements making up the consolidated statement of changes in equity and the consolidated cash flow statement.

Responsibilities of Directors and Those Charged with Governance for the Consolidated Financial Statements

[Reporting in accordance with HKSA 700 (Revised) – see Illustration 4 in HKSA 700 (Revised).]

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our responsibility is to conduct an audit of the Group's consolidated financial statements in accordance with Hong Kong Standards on Auditing ("HKSAs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and to issue an auditor's report. However, because of the matter described in the Basis for Disclaimer of Opinion section of our report, we were **not** able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these consolidated financial statements.

We are independent of the Group in accordance with the HKICPA's *Code of Ethics for Professional Accountants* ("the Code"), and we have fulfilled our other ethical responsibilities in accordance with the Code.

Report on Other Matters under sections 407(2) and 407(3) of the Hong Kong

Companies Ordinance

In respect alone of the inability to obtain sufficient appropriate audit evidence regarding an investment in a joint venture as described in the Basis for Disclaimer of Opinion section of our report above:

- we were unable to determine whether adequate accounting records had been kept; and
- we have not obtained all the information or explanations that, to the best of our knowledge and belief, are necessary and material for the purpose of the audit.

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

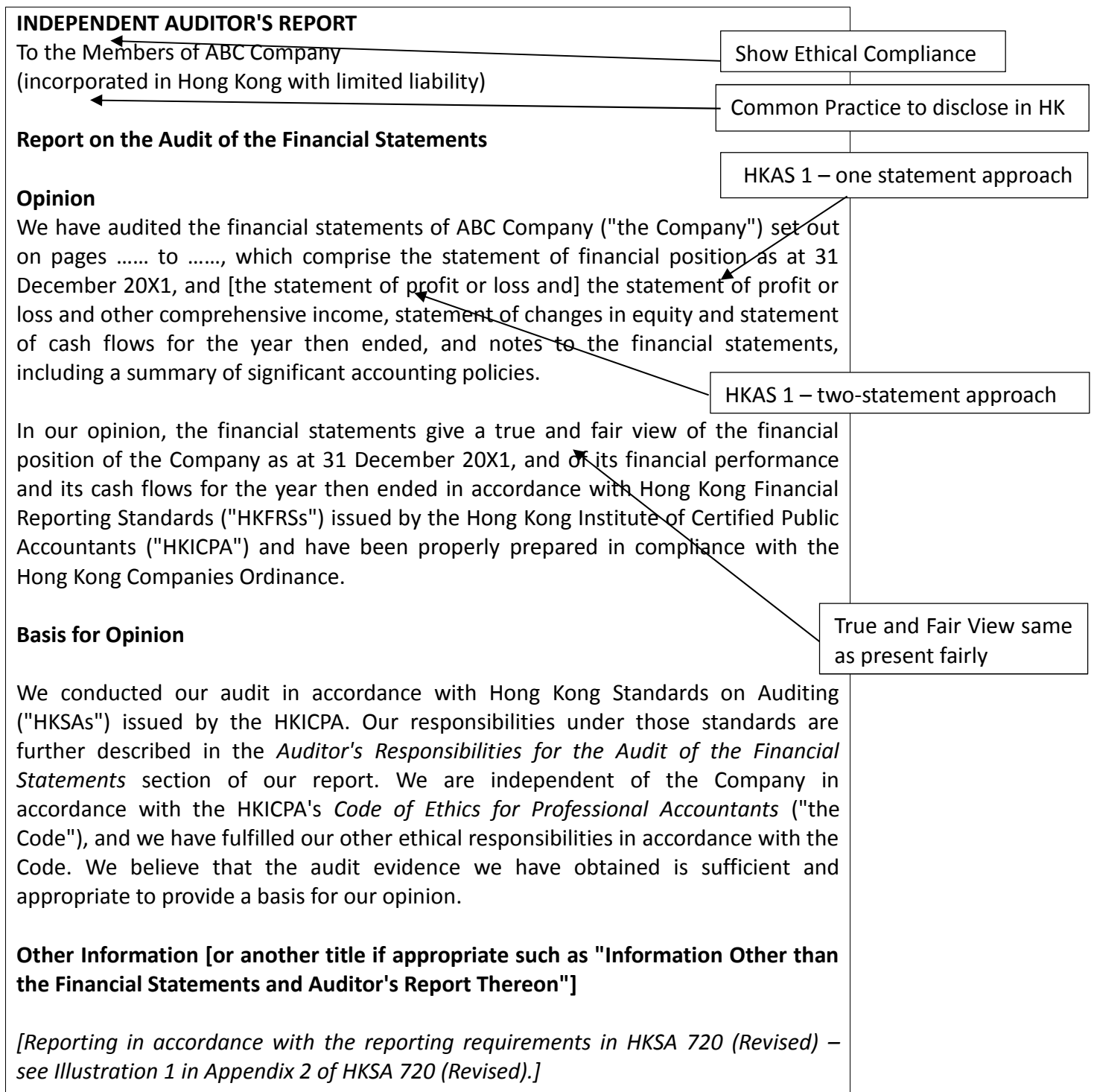
[Auditor Address]

[Date]

Prohibits a Key
Audit Matters
section or an
Other
Information
section

Unmodified Report – Company Level

Ref : HKSA 700 (Revised) - Illustration 3 – Auditor's Report for an Entity Other than a Listed Entity Incorporated in Hong Kong and where the Financial Statements are Prepared in Accordance with Hong Kong Financial Reporting Standards



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

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

Directors responsible for internal control

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

HKSA 570 – Consider the use of going concern assumption

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

Auditor's Responsibilities for the Audit of the Financial Statements

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

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities prescribed by local law or regulation. The matters addressed by other law or regulation (referred to as "other reporting responsibilities") shall be addressed within this section unless the other reporting responsibilities address the same topics as those presented under the reporting responsibilities required by the HKSAs as part of the Report on the Audit of the Financial Statements section. The reporting of other reporting responsibilities that address the same topics as those required by the HKSAs may be combined (i.e., included in the Report on the Audit of the Financial Statements section under the appropriate subheadings) provided that the wording in the auditor's report clearly differentiates the other reporting responsibilities from the reporting that is required by the HKSAs where such a difference exists.]

Refer to HKSA 705 (Revised)

XYZ & Co.
Certified Public Accountants (Practising) or Certified Public Accountants
[Auditor Address]
[Date]

Appendix to the auditor's report (Optional)

As part of an audit in accordance with HKSA's, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and **assess the risks of material misstatement** of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an **understanding of internal control** relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of **accounting estimates** and related disclosures made by the directors.
- Conclude on the **appropriateness of the directors' use of the going concern** basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the **overall presentation, structure and content** of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

No audit opinion on internal control

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Modified Report

Ref : HKSA 705 (Revised) - Illustration 1 – Qualified Opinion due to a Material Misstatement of the Financial Statements

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company
(incorporated in Hong Kong with limited liability)

Report on the Audit of the Financial Statements

Indicating the type of modification

Qualified Opinion

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

Relate to the Basis for Qualified Opinion Paragraph

In our opinion, **except for** the effects of the matter described in the *Basis for Qualified Opinion* section of our report, the financial statements give a true and fair view of the financial position of the Company as at 31 December 20X1, and of its financial performance and its cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Reasons for the modifications

Basis for Qualified Opinion

The Company's inventories are carried in the statement of financial position at xxx. The directors have not stated the inventories at the lower of cost and net realizable value but have stated them solely at cost, which constitutes a departure from HKFRSs. The Company's records indicate that, had the directors stated the inventories at the lower of cost and net realizable value, an amount of xxx would have been required to write the inventories down to their net realizable value. Accordingly, cost of sales would have been increased by xxx, and income tax, net income and shareholders' equity would have been reduced by xxx, xxx and xxx, respectively.

Financial effects of material misstatements

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

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

[Reporting in accordance with the reporting requirements in HKSA 720 (Revised) – see Illustration 6 in Appendix 2 of HKSA 720 (Revised). The last paragraph of the other information section in Illustration 6 would be customized to describe the specific matter giving rise to the qualified opinion that also affects the other information.]

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. In addition to the matter described in the *Basis for Qualified Opinion* section we have determined the matters described below to be the key audit matters to be communicated in our report.

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

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

[Reporting in accordance with HKSA 700 (Revised) – see Illustration 1 in HKSA 700 (Revised).]

Auditor's Responsibilities for the Audit of the Financial Statements

Report on Other Legal and Regulatory Requirements

[Reporting in accordance with HKSA 700 (Revised) – see Illustration 1 in HKSA 700 (Revised).]

The engagement partner on the audit resulting in this independent auditor's report is [name].

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[Auditor Address]

[Date]

Ref : HKSA 705 (Revised) - Illustration 2 –Adverse Opinion due to a Material Misstatement of the Consolidated Financial Statements

<p>INDEPENDENT AUDITOR'S REPORT</p>	
<p>To the Members of ABC Company (incorporated in Hong Kong with limited liability)</p>	
<p>Report on the Audit of the Consolidated Financial Statements</p>	<p>Change the heading</p>
<p>Adverse Opinion</p>	
<p>We have audited the consolidated financial statements of ABC Company and its subsidiaries ("the Group") set out on pages to, which comprise the consolidated statement of financial position as at 31 December 20X1, and [the consolidated statement of profit or loss and] the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.</p>	<p>Illustrate the significance</p>
<p>In our opinion, because of the significance of the matter discussed in the <i>Basis for Adverse Opinion</i> section of our report, the consolidated financial statements do not give a true and fair view of the consolidated financial position of the Group as at 31 December 20X1, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"). In all other respects, in our opinion the consolidated financial statements have been properly prepared in compliance with the Hong Kong Companies Ordinance.</p>	<p>FS not giving a true and fair view</p>
<p>Basis for Adverse Opinion</p>	<p>Opinion is still given</p>
<p>As explained in Note X, the Group has not consolidated subsidiary DEF Company that the Group acquired during 20X1 because it has not yet been able to determine the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This investment is therefore accounted for on a cost basis. Under HKFRSs, the Company should have consolidated this subsidiary and accounted for the acquisition based on provisional amounts. Had DEF Company been consolidated, many elements in the consolidated financial statements would have been materially affected. The effects on the consolidated financial statements of the failure to consolidate have not been determined.</p>	<p>Still can refer to a Note</p>
	<p>Indicate the pervasiveness ie "many elements"</p>

Executive Training Company (International) Limited

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

Still need to mention that the auditors have obtained sufficient and appropriate audit evidence

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

[Reporting in accordance with the reporting requirements in HKSA 720 (Revised) – see Illustration 7 in Appendix 2 of HKSA 720 (Revised). The last paragraph of the other information section in Illustration 7 would be customized to describe the specific matter giving rise to the qualified opinion that also affects the other information.]

Key Audit Matters

Except for the matter described in the *Basis for Adverse Opinion* section, we have determined that there are no other key audit matters to communicate in our report.

Responsibilities of Directors and Those Charged with Governance for the Consolidated Financial Statements

[Reporting in accordance with HKSA 700 (Revised) – see Illustration 2 in HKSA 700 (Revised).]

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

[Reporting in accordance with HKSA 700 (Revised) – see Illustration 2 in HKSA 700 (Revised).]

Report on Other Legal and Regulatory Requirements

[Reporting in accordance with HKSA 700 (Revised) – see Illustration 2 in HKSA 700 (Revised).]

The engagement partner on the audit resulting in this independent auditor's report is [name].

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[Auditor Address]

[Date]

Ref : HKSA 705 (Revised) - Illustration 3 –Qualified Opinion due to the Auditor's Inability to Obtain Sufficient Audit Evidence Regarding a Foreign Associate

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company
(incorporated in Hong Kong with limited liability)

Report on the Audit of the Consolidated Financial Statements

Qualified Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries ("the Group") set out on pages to, which comprise [the consolidated statement of profit or loss and] the consolidated statement of financial position as at 31 December 20X1, and the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

Indication of
except for

In our opinion, **except for** the possible effects of the matter described in the *Basis for Qualified Opinion* section of our report, the consolidated financial statements give a true and fair view of the financial position of the Group as at 31 December, 20X1, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and have been properly prepared in compliance with the Hong Kong Companies Ordinance.

Basis for Qualified Opinion

The Group's investment in DEF Company, a foreign associate acquired during the year and accounted for by the equity method, is carried at xxx on the consolidated statement of financial position as at 31 December 20X1, and ABC's share of DEF's net income of xxx is included in ABC's income for the year then ended. **We were unable to obtain sufficient appropriate audit evidence** about the carrying amount of ABC's investment in DEF as at 31 December 20X1 and ABC's share of DEF's net income for the year because we were denied access to the financial information, management, and the auditors of DEF. **Consequently, we were unable to determine whether any adjustments to these amounts were necessary.**

Describe the
limitation on scope

Executive Training Company (International) Limited

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

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

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. **In addition to the matter described in the Basis for *Qualified Opinion* section, we have determined the matters described below to be the key audit matters to be communicated in our report.**

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

Responsibilities of Directors and Those Charged with Governance for the Consolidated Financial Statements

[Reporting in accordance with HKSA 700 (Revised) – see Illustration 2 in HKSA 700 (Revised).]

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

[Reporting in accordance with HKSA 700 (Revised) – see Illustration 2 in HKSA 700 (Revised).]

No need to include the points already described in the Basis for Qualified Opinion

Report on Other Matters under sections 407(2) and 407(3) 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 as described in the Basis for *Qualified Opinion* section of our report above:

- we were unable to determine whether adequate accounting records had been kept; and
- we have not obtained all the information or explanations that, to the best of our knowledge and belief, are necessary and material for the purpose of the audit.

The engagement partner on the audit resulting in this independent auditor's report is *[name]*.

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[Auditor Address]

[Date]

Ref : HKSA 705 (Revised) - Illustration 4 - Disclaimer of Opinion due to the Auditor's Inability to Obtain Sufficient Appropriate Audit Evidence about a Single Element of the Consolidated Financial Statements

INDEPENDENT AUDITOR'S REPORT

To the Members of ABC Company
(incorporated in Hong Kong with limited liability)

Report on the Audit of the Consolidated Financial Statements

Disclaimer of Opinion

We were engaged to audit the consolidated financial statements of ABC Company and its subsidiaries ("the Group") set out on pages to, which comprise the consolidated statement of financial position as at 31 December 20X1, and [the consolidated statement of profit or loss and] the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

No opinion given

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

Basis for Disclaimer of Opinion

The Group's investment in its joint venture DEF Company is carried at xxx on the Group's consolidated statement of financial position, which represents over 90% of the Group's net assets as at 31 December 20X1. We were not allowed access to the management and the auditors of DEF Company, including DEF Company's auditors' audit documentation. As a result, we were unable to determine whether any adjustments were necessary in respect of the Group's proportional share of DEF Company's assets that it controls jointly, its proportional share of DEF Company's liabilities for which it is jointly responsible, its proportional share of DEF's income and expenses for the year, and the elements making up the consolidated statement of changes in equity and the consolidated cash flow statement.

Responsibilities of Directors and Those Charged with Governance for the Consolidated Financial Statements

[Reporting in accordance with HKSA 700 (Revised) – see Illustration 4 in HKSA 700 (Revised).]

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our responsibility is to conduct an audit of the Group's consolidated financial statements in accordance with Hong Kong Standards on Auditing ("HKSAs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and to issue an auditor's report. However, because of the matter described in the Basis for Disclaimer of Opinion section of our report, we were **not** able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these consolidated financial statements.

We are independent of the Group in accordance with the HKICPA's *Code of Ethics for Professional Accountants* ("the Code"), and we have fulfilled our other ethical responsibilities in accordance with the Code.

Report on Other Matters under sections 407(2) and 407(3) of the Hong Kong

Companies Ordinance

In respect alone of the inability to obtain sufficient appropriate audit evidence regarding an investment in a joint venture as described in the Basis for Disclaimer of Opinion section of our report above:

- we were unable to determine whether adequate accounting records had been kept; and
- we have not obtained all the information or explanations that, to the best of our knowledge and belief, are necessary and material for the purpose of the audit.

XYZ & Co.

Certified Public Accountants (Practising) or Certified Public Accountants

[Auditor Address]

[Date]

Prohibits a Key
Audit Matters
section or an
Other
Information
section